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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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

**COMMENTS
of the
ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT
OF SMALL TELECOMMUNICATIONS COMPANIES**

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SUMMARY

The existing high-cost support mechanism for rural ILECs, based on their actual embedded costs, has been highly successful in achieving its intended purpose: encouraging prudent investment in network infrastructure that has enabled the provision of affordable, high-quality services – including advanced services – throughout high-cost rural areas. The use of reverse auctions in rural service areas would jeopardize this record of success and place at significant risk the continued availability of “reasonably comparable” services and rates to rural consumers.

Reverse auctions do not naturally encourage network upgrades and service quality improvements. In addition, reverse auctions would likely make the capital markets more reluctant about making new loans to rural ILECs and result in a higher cost of capital. Furthermore, if a winning bidder (other than a rural ILEC) fails to meet the performance expectations established by regulators, there may not be a backup carrier capable of taking over the role of universal service provider.

Reforms to contain unnecessary growth in the rural High-Cost program should be tailored to directly target the root cause of the problem while not placing at risk the part of the program that is efficiently and effectively achieving the universal service goals of the Act. To accomplish this, the Joint Board should recommend that the identical support rule for competitive ETCs in rural service areas be eliminated and that support for these carriers be based on their own costs.

Data from USAC’s Fund size projections definitively demonstrates that the cause of unnecessary growth in the rural High-Cost program is competitive ETCs which, in turn, is caused by the illogical identical support rule. This rule creates arbitrage

opportunities for competitive carriers to seek ETC status in order to receive windfalls of support that exceed what is “sufficient.”

Cost-based support for competitive ETCs in rural service areas would create true accountability for the support these carriers receive since, like rural ILECs, support would be received only after legitimate costs have been incurred. In addition, it would ensure that only those competitive ETCs that demonstrate above-average costs that exceed a certain threshold receive funding. Thus, cost-based support would effectively eliminate the wasteful payout of windfall support amounts to competitive ETCs that threaten the Fund’s viability. At the same time, it would continue to ensure that all ETCs receive sufficient support to achieve the universal service goals of Congress and the FCC.

If, despite the substantial risks, the Joint Board still decides to recommend the use of reverse auctions for rural service areas, there are certain provisions that should be included. These provisions would improve the likelihood that the statutory universal service objectives will continue to be achieved and also establish equity in the system.

First, before applying reverse auctions to rural ILECs, they should first be tried for a significant period of time with non-ILEC (competitive) carriers. It would be unwise to immediately apply this untested approach to rural ILECs, who are the carriers of last resort in their service areas. By initially applying reverse auctions to competitive carriers, regulators can gain experience with this new system with minimal risk to the provision of universal service.

Second, rural ILECs should have an opportunity to recover the cost of network investments that were made prior to the adoption of reverse auctions. This would provide rural ILECs with the opportunity to modify their investment strategies accordingly and

minimize the amount of unrecovered capital costs that exist at the time the auctions mechanism is applied to them. Also, during the “phase-in” period, a rural ILEC’s support should not be frozen and the existing cap on high-cost loop support should be lifted.

Third, if reverse auctions are ultimately applied to both rural ILECs and competitive carriers, there should be one wireline and one wireless winner in each rural service area. Wireline and wireless services are viewed by most consumers as compliments, not substitutes. If there was only one support recipient per rural service area, and a wireline carrier was not selected, some rural consumers may no longer have access to highly-reliable wireline communications services – including advanced services – at affordable rates.

Fourth, price should not be the sole criteria for selecting auction winners in rural service areas. Quality of service, service capabilities, and existing service area coverage should all be included in the criteria for evaluating carriers bidding for a rural service area, and those criteria should be given at least equal weight as the bidding price.

Finally, if a rural ILEC is not selected as an auction winner, its end user rates should be deregulated and it should be relieved from carrier of last resort obligations. If not selected as a winning bidder, a rural ILEC should not be further competitively disadvantaged by regulations and obligations that would deprive them of the opportunity to recover their costs and remain a viable entity.

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I. INTRODUCTION

The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) hereby submits these comments in response to the Federal-State Joint Board on Universal Service's (Joint Board) Public Notice, released August 11, 2006.¹ The Public Notice seeks comment on the use of reverse auctions (competitive bidding) to determine eligibility for high-cost universal service support as well as carriers' funding levels.

OPASTCO is a national trade association representing over 550 small incumbent local exchange carriers (ILECs) serving rural areas of the United States. Its members, which include both commercial companies and cooperatives, together serve more than 3.5 million customers. All OPASTCO members are rural telephone companies as defined in 47 U.S.C. §153(37). OPASTCO members offer a wide array of

¹ *Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, FCC 06J-1 (rel. Aug. 11, 2006) (Public Notice).

communications services to rural consumers in addition to the traditional telephone services they provide as ILECs. These include dial-up Internet access, high-speed and advanced services, mobile wireless services, competitive local exchange service, long distance resale, and video services.

The existing high-cost support mechanism for rural ILECs, based on their embedded costs, has been effectively and efficiently achieving the statutory universal service objectives in rural service areas, as set forth in the Telecommunications Act of 1996 (1996 Act, the Act).² It has encouraged prudent investment in high-cost network infrastructure, and has enabled the provision of affordable, high-quality services – including advanced services – that are reasonably comparable to the services and rates offered in urban areas. The use of reverse auctions in rural service areas would needlessly place this record of success at significant risk, as auctions do not naturally encourage network investment, and could produce services and rates for rural consumers that are no longer “reasonably comparable.”

Therefore, if the goal of the Joint Board is to address the unnecessary growth in the rural High-Cost program, it should target its recommendations at the source of the problem – competitive eligible telecommunications carriers (ETCs) and the identical support rule. Specifically, the Joint Board should recommend that support for competitive ETCs in rural service areas be based on their own costs. This would eliminate the incentive these carriers have to seek ETC status merely to gain windfalls of support that exceed “sufficient” levels. Unlike the use of reverse auctions, this approach would address what is ailing the rural High-Cost program and jeopardizing its

² 47 U.S.C. §254(b).

sustainability, while preserving the part of the program that is successful and accountable to the public.

Nevertheless, if the Joint Board still decides to recommend the use of reverse auctions in rural service areas, there are certain provisions that should be included which would improve the likelihood that the Act's universal service objectives would continue to be met and that would establish equity in the mechanism. These provisions include: (1) reverse auctions should be tried with non-ILEC carriers first, before applying them to rural ILECs; (2) rural ILECs should have an opportunity to recover the cost of network investments that were made prior to the adoption of reverse auctions; (3) if reverse auctions are ultimately applied to both rural ILECs and competitive carriers, there should be one wireline and one wireless winner in each rural service area; (4) price should not be the sole criteria for selecting auction winners in rural service areas; and (5) if a rural ILEC is not selected as an auction winner, its end-user rates should be deregulated and it should be relieved from carrier of last resort obligations.

II. THE USE OF REVERSE AUCTIONS IN RURAL SERVICE AREAS POSES SIGNIFICANT RISKS TO THE CONTINUED AVAILABILITY OF "REASONABLY COMPARABLE" SERVICES AND RATES TO RURAL CONSUMERS

In the Public Notice, the Joint Board appropriately asks whether the use of reverse auctions would preserve and advance universal service and be consistent with the 1996 Act's universal service objectives, including rate comparability and affordability.³ The affordable, high-quality communications services – including advanced services – that are available throughout rural service areas are, in large part, a result of a support system based on actual embedded costs, which has enabled rural ILECs to prudently invest in

³ Public Notice, ¶6.

their networks. Unfortunately, the use of reverse auctions in rural service areas would jeopardize future network investment and place at significant risk the continued availability of “reasonably comparable” services and rates to rural consumers.

The Public Notice wisely asks what incentives an auction winner would have to maintain and upgrade its plant during its winning term.⁴ Reverse auctions do not naturally encourage network upgrades and service quality improvements that are critical to ensuring that rural consumers continue to have access to services that are comparable to those available in urban areas. Even if baseline quality of service obligations were adopted, the winner may be motivated to do the bare minimum required. For example, there is nothing to prevent deep-pocketed, urban-based carriers from “low balling” their bids in order to ensure that they win an auction. These carriers would then likely focus most of their resources on the higher-margin, densely populated areas that they serve and commit the bare minimum of resources to the high-cost areas for which the support is intended.

Even in the case of carriers that are committed to serving high-cost rural areas, reverse auctions may discourage necessary network investments. This is due to the fact that telecommunications networks require large investments in long-lived infrastructure, and without a reasonable expectation that these costs can be recovered, investments will not be made. If the remainder of an auction term is not long enough to recover the cost of a needed network upgrade, it is likely that a carrier will be unwilling to make the investment, fearing that they may not win the next auction and will be unable to recover the costs. This would be particularly problematic in the later years of a term. For example, a small, rural carrier will certainly not be able to justify a significant network

⁴ *Id.*, ¶10.

investment in the 8th or 9th year of a 10 year term when there is the possibility that it will no longer receive support within a year or two.

In addition, the adoption of a reverse auction support system would immediately threaten the outlook that lending institutions have of the stability and predictability of rural ILECs' core cash flows, which is the essential underpinning of most current loan structures. Investors would certainly be troubled by the possibility of stranded investment that could result from an auctions mechanism. This would likely make the capital markets more reluctant about making new loans to rural ILECs. At the very least, it would result in a higher cost of capital, thus making it more difficult for rural carriers to secure affordable financing for network improvements.

Another very significant risk of reverse auctions is that if a winning bidder (other than a rural ILEC) fails to meet the performance expectations established by the state commission or FCC, there may not be a backup carrier capable of taking over the role of universal service provider. By the time it is determined that the winning bidder is not performing satisfactorily, the previous carrier of last resort – *i.e.*, the rural ILEC – may be irreparably harmed from the lack of high-cost support and unable to step back in to provide service to the highest cost customers. In addition, the availability of advanced services could be significantly compromised as rural ILECs are often the only providers of broadband throughout their respective service areas.⁵

If there was no other carrier capable of serving as the universal service provider in a rural service area, either the expectations for service quality, capability, and coverage

⁵ A 2004 survey of OPASTCO's membership found that OPASTCO members, on average, were able to offer broadband to 88 percent of their customers. More than half of the respondents to the survey had made broadband available to at least 95 percent of their customers. More than one quarter indicated that they could deliver broadband to 100 percent of their customer base.

would have to be renegotiated downward or the support amount for the winning bidder would have to be renegotiated upward. In addition, end-user rates may have to increase. These outcomes are antithetical to the section 254 objectives of reasonably comparable services and rates as well as specific and predictable support.

Reverse auctions create the wrong incentives and pose too many risks to be used as a method for ensuring the continued provision of affordable, high-quality services, including advanced services, to all consumers in rural service areas. The pitfalls of reverse auctions far outweigh any advantages that such a support system may have. The existing support mechanism for rural ILECs, based on embedded costs, has been highly successful in achieving the Act's universal service objectives. The Joint Board should not tamper with a basis of support for rural ILECs that is accomplishing what it is intended to do.

III. REFORMS INTENDED TO ADDRESS THE UNNECESSARY GROWTH IN THE RURAL HIGH-COST PROGRAM SHOULD TARGET THE SOURCE OF THE PROBLEM: COMPETITIVE ETCS AND THE IDENTICAL SUPPORT RULE

Like the "block grant" proposals the Joint Board sought comment on in 2005,⁶ it appears that the primary goal of using reverse auctions to determine high-cost universal service funding is to reduce the size and growth of the High-Cost program. Excessive growth in the High-Cost program is a legitimate concern as it threatens the long-term sustainability of the Universal Service Fund (USF). However, reforms to contain unnecessary growth in the program should be tailored to directly target the root cause of the problem while not placing at risk the part of the program that is efficiently and

⁶ *Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, 20 FCC Red 14267 (2005)(August 2005 Notice).

effectively achieving the universal service goals of the Act. The use of reverse auctions in rural service areas would fail to accomplish this, as it would needlessly abandon the highly successful and fully accountable support system for rural ILECs, based on their embedded costs. Instead, the Joint Board should target the source of the problem by recommending that the identical support rule for competitive ETCs in rural service areas be eliminated and that support for these carriers be based on their own costs.

In its 2004 Portability Recommended Decision,⁷ the Joint Board stated that much of the growth in the High-Cost program represents supported wireless connections that supplement, rather than replace, wireline service. It found that there was the potential for uncontrolled growth as more and more competitive ETCs are designated in rural and high-cost areas. The Joint Board's findings could not have been more correct.

The chart below presents data from the Universal Service Administrative Company's (USAC) most recent quarterly Fund size projections for 4th Quarter 2006, and compares it with Fund size projections for 4th Quarter 2005 and 4th Quarter 2004, one and two years earlier.⁸ The data focuses solely on projected support for ILECs and competitive ETCs in rural telephone company study areas.

⁷ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 19 FCC Rcd 4257, 4285, ¶67 (2004) (Portability Recommended Decision).

⁸ Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2006* (Aug. 2, 2006), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2005* (Aug. 2, 2005), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2004* (Aug. 2, 2004), Appendix HC01. The support amounts presented for competitive ETCs reflect both existing competitive ETCs as well as competitive ETC applications that are pending. USAC includes support amounts for yet-to-be approved competitive ETCs in its Fund demand, which determines the contribution factor. Therefore, the inclusion of support amounts for pending competitive ETCs is appropriate in this type of analysis, since it is reflected in the contributions that carriers are required to make today.

Rural High-Cost Support Program	4th Quarter 2004 Support	4th Quarter 2005 Support	4th Quarter 2006 Support	% Change 4Q 2004 – 4Q 2006	Dollar Change 4Q 2004 - 4Q 2006	% of Total Two-Year Support Increase
(\$Millions)						
Rural ILEC	\$632.6	\$625.6	\$624.4	(1.3%)	(\$8.2)	(14.7%)
CETC	\$105.6	\$134.0	\$169.6	60.6%	\$64.0	114.7%
Total	\$738.2	\$759.6	\$794.0	7.6%	\$55.8	100.0%

This chart illustrates that support projections for rural ILECs actually declined by \$8.2 million over the past two years, making competitive ETCs responsible for more than 100 percent of the two-year projected growth in the rural High-Cost program. In fact, quarterly support projections for competitive ETCs in rural telephone company study areas grew by \$64 million over the past two years, from \$105.6 million to \$169.6 million – an increase of 60.6 percent.

The next chart below illustrates the growth in the number of competitive ETCs serving rural telephone company study areas and again is derived from USAC's Fund size projections for 4th Quarter 2004, 2005, and 2006.⁹

⁹ Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2006* (Aug. 2, 2006), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2005* (Aug. 2, 2005), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2004* (Aug. 2, 2004), Appendix HC01. In deriving the numbers reported in the chart, multiple appearances of a single study area code in any category were counted only once. For example, where USCellular (SAC 349016) appears twice in the rural ETC category -- once as an ETC and Eligible and once as an ETC and not-Eligible -- it was counted only one time for the purpose of this analysis. This results in a more conservative counting of competitive ETCs than the approach taken by USAC.

CETCs Serving Rural Study Areas	4th Quarter 2004	4th Quarter 2005	4th Quarter 2006
Approved CETCs	143	190	226
Pending CETCs	63	54	51
Total	206	244	277

This chart shows that in 4th Quarter 2004, there were 143 approved competitive ETCs serving rural study areas, with another 63 competitive ETC applications pending approval. Two years later, in 4th Quarter 2006, there were 226 approved competitive ETCs serving rural study areas, with another 51 applications awaiting approval. This amounts to a 58 percent increase in approved competitive ETCs in rural study areas in just two years. The Congressional Budget Office estimates that 95 percent of the high-cost support received by competitive ETCs goes to wireless carriers.¹⁰

Also, in numerous rural ILEC study areas, competitive ETCs are reporting a “remarkable” number of subscribers. Specifically, data from USAC’s 4th Quarter 2006 Fund size projections indicates that there are 22 rural study areas in which an approved competitive ETC reports more subscribers than the reported number of ILEC lines.¹¹ For example, Nemont Telephone Cooperative in North Dakota (SAC 382247) reports 191 lines while Northwest Dakota Cellular of North Dakota (SAC 389007), a competitive ETC serving the study area, reports 2,988 lines. If one is to believe Northwest Dakota Cellular, either Nemont is serving only 6 percent of the population in its study area, or

¹⁰ Congressional Budget Office, *Factors That May Increase Future Spending from the Universal Service Fund* (June 2006), Summary, p. IX; Chapter 3, p. 12.

¹¹ Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2006* (Aug. 2, 2006), Appendix HC18.

every one of Nemont's customers has, on average, about 15 Northwest Dakota mobile phones, each with a different phone number.¹²

Thus, it is evident that the cause of unnecessary growth in the rural High-Cost program is competitive ETCs which, in turn, is caused by the illogical identical support rule. The identical support rule enables competitive ETCs to receive the same per-line support as the rural ILEC, based on the ILEC's costs, for every customer that the competitive ETC serves in its designated territory. This creates arbitrage opportunities for competitive carriers to seek ETC status in order to receive windfalls of support that exceed the "sufficient" levels called for in section 254(b)(5) of the 1996 Act. Consequently, the long-term sustainability of the Fund is needlessly jeopardized and ratepayers nationwide are unnecessarily burdened. Also, considering the stark differences that exist between rural ILECs and competitive ETCs, the identical support rule fails to adhere to the FCC's universal service principle of competitive neutrality.¹³

Competitive ETCs, particularly the overwhelming majority that are wireless carriers, provide service under a completely different set of conditions than rural ILECs. Competitive ETCs operate with far few regulations and obligations imposed on them, their designated service areas are usually different, they have not typically built out their networks to provide robust service in the more remote sections of a rural territory, and they provide a completely different level and quality of service. In addition, the support that rural ILECs receive is for the recovery of actual reported costs that have been prudently incurred in the provision of ubiquitous service throughout their territory. On

¹² Interestingly, based on the same USAC report, five other wireless competitive ETCs are also reporting customers in Nemont's service territory. However, collectively these five carriers account for only 27 competitive ETC lines.

¹³ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45. Report and Order, 12 FCC Red 8776, 8801, ¶47 (1997).

the other hand, CETCs, once designated, receive funding immediately for all of their customers, including those that they were successfully serving without any support.

The existing rural ILEC support mechanism, based on their actual embedded costs, has been highly successful in achieving its intended purpose: encouraging investment in network infrastructure that has enabled the provision of affordable, high-quality services throughout high-cost rural areas.¹⁴ Moreover, the existing rural support mechanism has been instrumental to rural ILECs' ability to deploy the multi-functional infrastructure capable of providing broadband and related advanced services. This is because support based on embedded costs creates a direct relationship between rural ILECs' actual network investments and the support amounts they receive. This provides rural carriers with a reasonable level of confidence that they will have the opportunity to fully recover their costs. Without a direct link between the cost of network investments and support, rural ILECs would be reluctant to make substantial network upgrades, particularly those necessary to offer advanced services.

Furthermore, rural ILECs have strong incentives to remain efficient under a support mechanism based on embedded costs. To begin with, universal service support recovers only a portion of rural ILECs' costs. In addition, rural carriers operate in a competitive environment and must respond to threats coming from wireless carriers, voice over Internet protocol (VoIP) providers, and long distance carrier access bypass, among others. Also, rural ILECs' costs and operations undergo significant scrutiny and oversight from auditors, regulators, lenders and shareholders.

¹⁴ See, OPASTCO comments in CC Docket No. 96-45 (fil. Oct. 15, 2004), pp. 7-11; OPASTCO reply comments in CC Docket No. 96-45 (fil. Dec. 14, 2004), pp. 8-14; OPASTCO reply comments in CC Docket No. 96-45 (fil. Oct. 31, 2005), pp. 11-13.

OPASTCO has serious concerns that the use of reverse auctions in rural service areas would needlessly abandon the embedded-cost basis of support for rural ILECs, which is effective and efficient, in the process of excising what is clearly not working – the identical support rule for competitive ETCs. However, there is no need for the Joint Board to “throw the baby out with the bathwater.” Instead, the Joint Board should specifically target what is ailing the rural High-Cost program by recommending that the identical support rule be eliminated in rural service areas and that competitive ETCs receive support based on their own costs.

Cost-based support for competitive ETCs in rural service areas would introduce the same rationality and accountability into the mechanism for these carriers that already exists for rural ILECs.¹⁵ It would also establish competitive neutrality in the support mechanism for both types of carriers. Notwithstanding the ETC eligibility and reporting guidelines adopted in the FCC’s 2005 ETC Designation Order,¹⁶ it is still difficult to know with any degree of certainty whether the support received by competitive ETCs is being used only for the purposes for which it was intended.¹⁷ By basing support for competitive ETCs in rural service areas on their own costs, it would create true accountability for the support these carriers receive since, like rural ILECs, support would be received only after legitimate costs have been incurred. In addition, it would

¹⁵ See, OPASTCO comments in CC Docket No. 96-45 (fil. May 5, 2003), pp. 16-18; OPASTCO reply comments in CC Docket No. 96-45 (fil. Jun. 3, 2003), pp. 5-7; OPASTCO comments in CC Docket No. 96-45 (fil. Oct. 15, 2004), pp. 12-18; OPASTCO reply comments in CC Docket No. 96-45 (fil. Dec. 14, 2004), pp. 14-20; OPASTCO comments in CC Docket No. 96-45 (fil. Sept. 30, 2005), pp. 15-17; OPASTCO reply comments in CC Docket No. 96-45 (fil. Oct. 31, 2005), pp. 16-18.

¹⁶ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 20 FCC Rcd 6371 (2005).

¹⁷ Section 254(e) of the 1996 Act states that “[a] carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.” 47 U.S.C. §254(e).

ensure that only those competitive ETCs that demonstrate above-average costs that exceed a certain threshold receive funding.¹⁸

Thus, cost-based support for competitive ETCs in rural service areas would effectively eliminate the wasteful payout of windfall support amounts that threaten the Fund's viability. At the same time, it would continue to ensure that all ETCs receive sufficient support for their infrastructure investments in high-cost areas necessary to achieve the universal service goals of Congress and the FCC. Responsible stewardship of limited public funding demands a high level of confidence that the High-Cost program is achieving its objectives and is being used for its intended purposes by all carriers receiving support.¹⁹

IV. IF THE JOINT BOARD DECIDES TO RECOMMEND THE USE OF REVERSE AUCTIONS FOR RURAL SERVICE AREAS, THERE ARE CERTAIN PROVISIONS THAT SHOULD BE INCLUDED TO IMPROVE THE LIKELIHOOD THAT THE STATUTORY UNIVERSAL SERVICE OBJECTIVES WILL CONTINUE TO BE MET AND TO CREATE FAIRNESS IN THE MECHANISM

As explained in the preceding sections, the use of reverse auctions to determine high-cost support eligibility and support amounts in rural service areas carries with it substantial risks for the continued provision of universal service to rural consumers. It also fails to isolate the sole cause of unnecessary growth in the rural High-Cost program – competitive ETCs and the identical support rule. That said, if the Joint Board still

¹⁸ OPASTCO continues to be supportive of the development of an average schedule-like option for competitive ETCs, based on the actual costs of similarly situated carriers using the same technology. This would give competitive ETCs the same options as rural ILECs and afford them the same opportunity to avoid the administrative costs of developing an annual cost study.

¹⁹ As an alternative to basing support for competitive ETCs in rural service areas on their own costs, the Joint Board should also consider the establishment of a separate support mechanism for wireless ETCs, as suggested in the "Universal Service Endpoint Reform Plan" within the Joint Board's August 2005 Notice. *See*, August 2005 Notice, 20 FCC Rcd 14292-14293. This proposal has merit because it would provide greater assurance that the funds received by wireless competitive ETCs would be used to achieve expanded service coverage that otherwise may not have occurred absent the receipt of support. This would maximize the public benefit derived from the funds received by wireless competitive ETCs.

decides to recommend the use of reverse auctions for rural service areas, there are certain provisions that should be included to improve the likelihood that the Congressional universal service objectives will continue to be achieved and to create equity in the mechanism.

A. Before applying reverse auctions to rural ILECs, they should first be tried with non-ILEC (competitive) carriers

The adoption of reverse auctions would obviously be a fundamental change in the rules for determining high-cost support eligibility and support amounts in rural service areas. It is a novel approach that neither the FCC nor state commissions have any experience with for universal service purposes. It would therefore be unwise to immediately apply this untested approach to rural ILECs, who are the only providers of ubiquitous, high-quality, facilities-based telecommunications services throughout their respective service areas. Instead, reverse auctions should be tried first, for a significant period of time, with non-ILEC (competitive) carriers, where there is much less risk to the provision of universal service, should the approach fail to produce the desired results.

Rural ILECs are the historical carriers of last resort in their respective service areas. They have made huge network investments in order to offer high-quality telecommunications services to all of the consumers in their service areas, including those living in the most remote and highest-cost regions. Most of them have also made significant investments to deploy broadband to a substantial percentage of their customers and they are frequently the only provider of reliable broadband service in their communities. These network investments were made possible, in significant part, by the availability of high-cost support, which recovers a portion of those investment costs.

If a carrier other than the ILEC were chosen as the winning bidder in a reverse auctions system, many rural ILECs would be forced to limit or even halt future network investments, causing some of their plant to deteriorate and become outdated. Some carriers may need to exit the market entirely. As a result, if the winning bidder subsequently did not perform as expected, the rural ILEC may no longer be capable of “picking up the pieces” and providing high-quality, modern service throughout the area. At greatest risk would be continued service to the most remote customers for whom there are no other service alternatives.

On the other hand, most rural areas have multiple “competitive” carriers – primarily wireless providers – serving the area.²⁰ However, because few wireless carriers have made the necessary investments to provide robust coverage in the most rural portions of their license area, those wireless providers that are not chosen as the winning bidder should not be financially harmed. If a winning wireless bidder is not meeting its universal service obligations, another should be available to take over that role.

By initially applying reverse auctions to competitive carriers, the FCC and state commissions can gain experience with this new system with minimal risk to the provision of universal service in high-cost rural areas. During that period, the FCC can decide whether or not an auctions approach is workable and appropriate for rural ILECs. If the FCC determines that reverse auctions should be applied to rural ILECs, it will have the benefit of the experience gained from applying them to non-ILECs, and will have had an opportunity to correct any rules that may have produced unintended consequences.

²⁰ The FCC’s Eleventh CMRS Competition Report finds that less densely populated counties (100 persons per square mile or less) have an average of 3.6 mobile competitors. *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, WT Docket No. 06-17, Eleventh Report, FCC 06-142 (rel. Sept. 29, 2006), ¶86 (Eleventh CMRS Competition Report).

B. Rural ILECs should have an opportunity to recover the cost of network investments that were made prior to the adoption of reverse auctions

The Public Notice asks how an auctions mechanism would avoid stranded investments.²¹ It is unlikely that stranded investments could be avoided entirely. However, they could be minimized by adopting a transition period for rural ILECs that is long enough to enable them to recover the cost of network investments that had already been made under the existing rural high-cost support system, prior to the adoption of an auctions mechanism.

Under a compact with regulators, rural ILECs have built out their networks to provide ubiquitous, high-quality service with the understanding that universal service support would be available to recover a certain portion of the cost. Absent the existing rural high-cost support mechanism and the opportunity to achieve full cost recovery, these investments would have never been made and there would not be the availability and quality of service in rural service areas that exists today. Therefore, prior to the application of a reverse auctions mechanism on rural ILECs – which may provide them with less support, or possibly no support at all – it is only fair that they be given the opportunity to recover the cost of their outstanding investments, that were made under the existing system and without the knowledge that an auctions mechanisms would be adopted. This would provide rural ILECs with the opportunity to revise their investment strategies accordingly and minimize the amount of unrecovered capital costs that exist at the time the auctions mechanism is applied to them.

²¹ Public Notice, ¶13.

Equally important is that during the transition or “phase-in” period, a rural ILEC’s support should not be frozen, as suggested in the Public Notice discussion proposal.²² Instead, the existing cap on the high-cost loop support mechanism²³ should be lifted so that rural ILECs can receive the appropriate amount of support for the investments that they have made, which would facilitate full cost recovery. In addition, a freeze on support would serve as a strong disincentive for rural ILECs to make further infrastructure investments that would enable the deployment of broadband to greater numbers of rural consumers. This is antithetical to the goal of ubiquitous broadband availability held by the Administration, Congress, and the FCC.

C. If reverse auctions are ultimately applied to both rural ILECs and competitive carriers, there should be one wireline and one wireless winner in each rural service area

Should reverse auctions be applied to all carriers in rural service areas, there should be one wireline carrier and one wireless carrier selected as winners in each area. Wireline and wireless services are viewed by most consumers as complements, not substitutes. That is, “...relatively few wireless customers have ‘cut the cord’ in the sense of canceling their subscription to wireline telephone service...”²⁴ This is due to differences in the functionality that consumers derive from the two types of services. For instance, the FCC has recognized that “[w]hereas wireless services may have a comparative advantage over wireline services in providing the consumer mobility, wireline local exchange services may have comparative advantages in reliability, E-911

²² *Id.*, p. 9.

²³ 36 C.F.R. §36.603.

²⁴ Eleventh CMRS Competition Report, ¶215. The Eleventh CMRS Competition Report suggests that about 8 percent of U.S. households that subscribe to cellphone service had given up their landline phones. *Id.*, ¶205. It is likely that this percentage is lower in rural areas, where network coverage in neighborhoods is less robust than in urban areas.

coverage, ubiquity, and lower-cost unlimited local calling.”²⁵ Wireline carriers also have far greater network capacity to carry data traffic than wireless carriers.

Consumers residing in urban areas have access to both wireline and wireless services. If there was only one support recipient per rural service area, and a wireline carrier was not selected, some high-cost rural consumers may no longer have access to highly-reliable wireline telecommunications services at affordable rates. Also, without a supported wireline carrier, it is likely that significant numbers of rural consumers would no longer have access to an affordable broadband connection, and some consumers may be left without broadband availability altogether. This, in turn, would make services that require a broadband connection, such as VoIP, unavailable to rural consumers. These outcomes are wholly inconsistent with the section 254 objective of services and rates in rural areas that are reasonably comparable to those offered in urban areas.

In addition, wireless carriers are dependent upon wireline switching and transport facilities to deliver many of their calls. Without a robust wireline network nationwide, wireless service would not exist at its present level of reliability. Therefore, the continuance of a supported wireline carrier in rural service areas is critical not only for the benefit of the end-user services that wireline carriers offer consumers, but also for the benefit of wireless services in rural areas and nationwide.

²⁵ *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations, File Nos. 0001656065, et. al., WT Docket No. 04-70, Applications of Subsidiaries of T-Mobile USA, Inc. and Subsidiaries of Cingular Wireless Corporation For Consent to Assignment and Long-Term De Facto Lease of Licenses, File Nos. 0001771442, 0001757186, and 0001757204, WT Docket No. 04-254, Applications of Triton PCS License Company, LLC, AT&T Wireless PCS, LLC, and Lafayette Communications Company, LLC For Consent to Assignment of Licenses, File Nos. 0001808915, 0001810164, 0001810683, and 50013CWAA04, WT Docket No. 04-323.* 19 FCC Rcd 21522, 21612-21613, fn. 559 (2004).

D. Price should not be the sole criteria for selecting auction winners in rural service areas

In order to better ensure the availability of high-quality, “reasonably comparable” services from auction winners in rural service areas, winning bids should be selected on the basis of multiple criteria, not limited to price. The discussion proposal in the Public Notice correctly takes this approach.²⁶

Quality of service, service capabilities, and existing service area coverage should all be included in the criteria for evaluating carriers bidding for a rural service area, and those criteria should be given at least equal weight as the bidding price. In addition, when evaluating bidding carriers, regulators should consider that a carrier that provides a higher quality of service or greater service capabilities than other carriers will likely bid a higher price. However, the higher price does not necessarily mean that the carrier is less efficient than other carriers; the price merely reflects the investments that have already been made to provide a higher level of service to rural consumers in the area.

Selecting winners based solely on price would surely be a “race to the bottom.” It would enable large, deep-pocketed carriers to underbid small, rural carriers – both wireline and wireless – and automatically win the auction. However, history has shown that these carriers have not been nearly as committed as small, rural carriers to investing in rural areas and providing the highest-quality service possible.²⁷ The Joint Board should not put containment of the size and growth of the Fund ahead of ensuring that

²⁶ Public Notice, p. 8.

²⁷ See, Belson, Ken, *Rural Areas Left in Slow Lane of High-Speed Data Highway*, The New York Times (Sept. 28, 2006), A1. (“Big phone and cable companies are reluctant to upgrade and expand their networks in sparsely populated places where there are not enough customers to justify the investment. Instead, they are funneling billions of dollars into projects in cities and suburbs where the prospects for a decent return are higher.”)

rural consumers have access to high-quality telecommunications and information services that are reasonably comparable to those available in urban areas.

E. If a rural ILEC is not selected as an auction winner, its end-user rates should be deregulated and it should be relieved from carrier of last resort obligations

If a rural ILEC is not a winning bidder, it should not be further competitively disadvantaged by regulations and obligations that would deprive them of the opportunity to recover their costs and remain a viable entity. Therefore, rural ILECs that are not auction winners should no longer have their end-user rates regulated and should be permitted to charge a market-based rate. This will at least provide them with the opportunity to recover directly from end-users the cost of providing service. Certainly, if there is another provider serving a rural ILEC's territory that the state commission and/or FCC believes is capable of providing universal service throughout the area, there must be ample competition to constrain the ILEC's end-user rates and justify rate deregulation.

Rural ILECs that are not auction winners should also be freed of their carrier of last resort obligations and permitted to discontinue service availability to customers that they decide are no longer economical to serve. In addition, they should be permitted to exit the market entirely. If the state commission and/or FCC believe that a carrier other than the ILEC is better suited to provide universal service in a rural service area, then theoretically all consumers in the area should have access to affordable and reasonably comparable services and rates, and removing the ILEC's carrier of last resort obligations should not be detrimental to the community.

In short, regulators should be held accountable for the auction winners that they select. If a rural ILEC is not selected as a winning bidder, it should not be expected to act as a “standby” in the event that a winning carrier fails to perform to expectations.

V. CONCLUSION

The Joint Board should not recommend the use of reverse auctions in rural service areas. Such a mechanism would needlessly place at risk the continued availability of affordable, high-quality communications services, including advanced services, for many rural consumers. Instead, the Joint Board should recommend the elimination of the identical support rule in rural service areas and that support for competitive ETCs in these areas be based on their own costs. This approach would target the cause of unnecessary growth in the rural High-Cost program, while not abandoning the highly successful and fully accountable high-cost mechanism for rural ILECs, based on their embedded costs. If, however, the Joint Board decides to recommend the use of reverse auctions in rural service areas, there are certain provisions that should be included, which are detailed in Section IV above. These provisions would improve the likelihood that the statutory universal service objectives would continue to be achieved and also establish fairness in the mechanism.

Respectfully submitted,

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October 10, 2006

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I, Brian J. Ford, hereby certify that a copy of the comments of the Organization of the Promotion and Advancement of Small Telecommunications Companies was sent by electronic mail on this, the 10th day of October, 2006, to those listed on the attached list.

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