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

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Federal Communications Commission
Office of the Secretary

In the Matter of	)	
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High-Cost Universal Service Support	)	WC Docket No. 05-337
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COMMENTS OF THE UNITED STATES TELECOM ASSOCIATION

TO THE

FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

ON THE

PUBLIC NOTICE REGARDING THE MERITS OF USING AUCTIONS TO DETERMINE HIGH-COST UNIVERSAL SERVICE SUPPORT

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SUMMARY OF COMMENTS

As the Joint Board and the Commission consider systemic reform of the universal service distribution mechanism, they should be guided by the fundamental goals of the support regime, and remain mindful of its great successes thus far. Whether the Joint Board recommends an auction-based methodology, continuation of the current distribution framework, or an alternative system, it must ensure that the approach chosen—and the specific details of its implementation—are consistent with the overriding aim of ensuring deployment in rural and other high-cost areas. This aim has served our nation well for decades, conferring all manner of benefits on Americans not only in rural areas but throughout the country.

USTelecom emphasizes several points in these Comments.

First, universal service is vital to the people of our country, and their economic well being. The principle of universal service has been a cornerstone of telecommunications law and policy for nearly a century, and our nation's telecommunications network has helped define the fabric of American life.

Second, high-cost support is necessary to ensure universal service as defined in the Communications Act—high-quality service at comparable rates. The cost of providing telecommunications service varies significantly depending on population density, the distance over which infrastructure must be deployed, topography, and socioeconomic conditions.

Third, any high-cost distribution mechanism must follow several core principles, namely preserving the economic viability of critical networks, facilitating the provision of affordable service to all consumers at comparable rates throughout the country, and providing predictable, sufficient, and sustainable support.

Fourth, the current high-cost support mechanism is strained by flawed distribution policies. Regulatory asymmetries are interfering with competition; the implicit subsidies used to support service in high-cost areas are at risk; and the current system supports multiple networks in areas where market-based competition cannot even support a single network and allows for the possibility of sending high-cost support payments to competitors that do not even serve the high-cost lines for which support is intended, which accentuates the harm to competition.

Fifth, alternative high-cost support mechanisms may be useful but they should be analyzed carefully as they may be more or less effective depending on how they are implemented. Indeed, the critical question may be how well a particular mechanism is implemented.

Sixth, the Public Notice raises many important questions, and there are many other critical questions to be answered. The universal service regime of today has been structured around the fundamental choices the Commission made when first implementing section 254. The Public Notice revisits many, or even most, of those choices, however, many crucial issues remain unaddressed. USTelecom supports the Board's interest in reform, and thus takes this opportunity to highlight other key questions that must be answered as policymakers contemplate new frameworks like those described in the Public Notice.

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COMMENTS OF THE UNITED STATES TELECOM ASSOCIATION

As the Federal-State Joint Board on Universal Service (Joint Board or Board) and the Federal Communications Commission (Commission or FCC) consider systemic reform of the universal service distribution mechanism, they should be guided by the fundamental goals of the support regime, and remain mindful of its great successes thus far. The principle of universal service has been a cornerstone of telecommunications law and policy for nearly a century, and it remains as essential today as ever before. For more than a century, our nation's telecommunications network has helped define the fabric of American life. At its core, universal service stands for the proposition that telecommunications infrastructure should be available throughout the country like other essential components of our national infrastructure, such as roads and electricity.

Whether the Joint Board recommends an auction-based methodology, continuation of the current distribution framework, or an alternative system, it must ensure that the approach chosen—and the specific details of its implementation—are consistent with the overriding aim of ensuring deployment in rural and other high-cost areas. This aim has served our nation well for decades, conferring many benefits on Americans not only in rural areas but throughout the country.

In brief, the United States Telecom Association (USTelecom)[1] emphasizes several points: (1) universal service is vital to the people of our country, and to their economic well being; (2) high-cost support is necessary to ensure universal service; (3) any high-cost distribution mechanism must follow several core principles, namely preserving the economic viability of critical networks, facilitating the provision of affordable service to all consumers at comparable rates throughout the country, and providing predictable, sufficient, and sustainable support; (4) the current high-cost support mechanism is strained by flawed distribution policies; (5) alternative high-cost support mechanisms may be useful but should be analyzed carefully; and (6) the Public Notice raises many important questions, and there are many other critical questions to be answered.

I. UNIVERSAL SERVICE IS VITAL FOR THE UNITED STATES OF AMERICA

Congress stated in the very first section of the Communications Act of 1934, the chief goal of American communications policy is "to make available, so far as possible, to *all people of the United States* ... a rapid, efficient, nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." Like the electrification of the countryside and the building of our nation's highways, the ubiquitous presence of telephones in virtually every American home stands as one of the nation's landmark achievements of the 20th century and a testament to the efficacy and value of the universal service program.

Telecommunications infrastructure supports the nation's economic health. The universal availability of communications infrastructure is the connective tissue that binds our national

[1] USTelecom is the nation's leading trade association representing communications service providers and suppliers for the telecom industry. USTelecom's carrier members provide a full array of voice, data, and video services across a wide range of communications platforms.

resources to our market economy. Many industries, such as agriculture, mining, manufacturing, and tourism would produce less, and would be less viable in many places, without ubiquitous, high-quality, and affordable telecommunications services. Similarly, businesses and individuals in high-cost areas would be unable to participate as fully in our economy as producers and consumers of goods and services. The universal availability of critical infrastructure facilitates and supports innovation and investment in the human resources that are essential for our economic future. As information processing becomes an increasingly central aspect of our economy, we simply cannot afford to leave parts of our country disconnected.

Telecommunications infrastructure also supports homeland security. The goal of protecting our society is not achievable if those living in high-cost areas are disconnected from society as a whole. It is impossible to protect our country against terrorism or criminal activity if there are substantial land areas that are isolated from our critical road, electrical, and communications infrastructures. Similarly, ubiquitous availability of high-quality, affordable telecommunications services facilitates our local and national responses to natural disasters, such as hurricanes. As FCC Chairman Martin wrote last month when announcing the creation of the Commission's Homeland Security Bureau, "[t] he events of September 11th, 2001 and last year's Hurricane season underscored America's reliance on an effective national telecommunications infrastructure."[2]

Finally, ubiquitous communications offerings benefit everybody, including those living in low-cost regions, because they expand contact with others who might otherwise remain unconnected. As economists note, in fields subject to "network effects," goods or services are

[2] *Establishment of the Public Safety and Homeland Security Bureau And Other Organizational Changes*, Order, __ FCC Rcd ____, FCC 06-35 (separate statement of Chairman Kevin J. Martin) (Sep. 25, 2006).

more valuable to each customer when other customers also use them.[3] The more people and places we can call, the more we can rely on telecommunications and the more valuable the network becomes for each of us.

As Congress contemplated codification of the universal service regime in the 1996 Act, legislators from across the political spectrum highlighted the crucial importance of ensuring service to all areas of our country. Recognizing that rural areas often posed high costs for telecommunications network deployment, Senator Stevens said that the Act's universal service provisions "mean that rural America will come into the 21st century with everyone else as far as telecommunications is concerned."[4] Senator Snowe also addressed the need for support in high-cost areas, so that "[r]esidents of rural areas should bear no more cost for essential telecommunications services than residents of densely populated areas."[5] Democratic Senators agreed: Senator Daschle, for example, stated that "[w]e must make certain that our rural areas are not left behind as services expand and new products come on line," and predicted that "accessibility to these new telecommunications services will be the harbinger for a new renaissance among the main street economies in communities throughout rural America."[6]

In light of these concerns, Congress amended the Communications Act to require, among other things, that the federal universal service program must: ensure universal "availability of quality services at just, reasonable, and affordable rates"; allow for nationwide access to services "that are reasonably comparable to those services provided in urban areas and that are available

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[3] *E.g.*, Joseph Farrell & Garth Saloner, *Standardization, Compatibility, and Innovation*, 16 RAND Journal of Economics 70 (Spring, 1985); Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 American Economic Review 424 (Jun. 1985);

[4] 142 Cong Rec S 687 (Feb. 1, 1996).

[5] *Id.*

[6] *Id.*

at rates that are reasonably comparable to rates charged for similar services in urban areas"; and provide "specific, predictable and sufficient" levels of support."[7] President Clinton specifically cited his support for provisions "requir[ing] interstate telecommunications carriers to contribute to a fund to preserve and advance universal service," which he noted "would be spent to provide and upgrade facilities and services, as prescribed by the FCC."[8]

Like the Congress, various FCC Commissioners have repeatedly recognized the importance of ensuring sufficient support for rural deployment. FCC Chairman Kevin J. Martin has made clear:

> A modern and high quality telecommunications infrastructure is essential to ensure that all Americans, including those residing in rural communities, have access to the economic, educational, and healthcare opportunities available on the network. Our universal service program must continue to promote investment in rural America's infrastructure and ensure access to telecommunications services that are comparable to those available in urban areas, as well as provide a platform for delivery of advanced services.[9]

Commissioner Copps has also noted the importance of ensuring that carriers serving high-cost areas "can plan for the future and undertake necessary investment to modernize the

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[7] 47 U.S.C. § 254(b). As the courts have emphasized, the Commission must fulfill *all* of these principles. *See Qwest Comm. Int'l Inc. v. FCC*, 398 F.3d 1222 (9th Cir. 2005) (*Qwest II*); *Qwest Corp. v. FCC*, 258 F.3d 1191 (9th Cir. 2001).

[8] President William J. Clinton, Statement on Signing the Telecommunications Act of 1996 (Feb. 8, 1996).

[9] *Federal-State Joint Board on Universal Service*, 18 FCC Rcd 2943, Statement of Commissioner Kevin J. Martin (2002). *See also Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, 20 FCC Rcd 11308, Separate Statement of Chairman Kevin J. Martin (2005) (citing the "critical function" served by universal service "to ensure access for consumers in rural and high-cost areas").

telecommunications infrastructure in their communities."[10] And Commissioner Adelstein has underscored the clear nexus between universal service and economic success:

> Universal service has been the cornerstone of telecommunications policy for over 70 years and has enabled this country to enjoy unparalleled levels of access to essential communications services. That access has improved our economic productivity and our public safety in immeasurable ways and has been vital in fostering economic development in rural and underserved areas.[11]

This Board agreed when it passed on the Rural Task Force's recommendations for the Commission's consideration in 2000:

> A high quality telecommunications infrastructure is necessary in order to provide for the economic, educational, health care and other opportunities essential to the future vitality of our rural communities. The Task Force reached agreement that a primary purpose of universal service support is to promote investment by both ILECs and CLECs in rural America's telecommunications infrastructure. This investment is necessary to ensure universal access to telecommunications services which are comparable to those available in urban areas, and to provide a platform for delivery of advanced services.[12]

The need for sustainable universal service remains today. President Bush has highlighted the crucial importance of advanced telecommunications capacity to the development of "new ideas and new businesses and new ways to educate people,"[13] and one of his administration's chief aims is to "provide American consumers with the most affordable and highest quality broadband service in the world."[14] Less than one month ago, Senator Stevens explained that

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[10] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 19613, Statement of Commissioner Michael J. Copps (2001).

[11] *Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, Statement of Commissioner Jonathan Adelstein (2004).

[12] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 16 FCC Rcd 6153, 6177 (Jt. Bd. 2000).

[13] President George W. Bush, Remarks in Albuquerque, New Mexico, March 26, 2004.

[14] The White House, *A New Generation of American Innovation* at 11 (April 2004).

universal service "is a concept that makes communications available to rural America which is critical," and referred to such access as "a new right for American citizens."[15] Also within the past month, Senator Reid commented that "[r]ural areas are consistently left behind urban areas when it comes to federal investment in the infrastructure systems that are essential for any economy to thrive – including telecommunications systems."[16]

In sum, federal policymakers of all stripes consistently have emphasized the importance of ensuring that rural telecommunications networks are capable of providing services akin to those available in other areas, at affordable prices. Efficiency and cost reduction are, of course, laudable objectives. In considering reform of the high-cost regime, however, the Board must take care not to pursue these ends at the expense of the statutory goals that the system was designed to further in the first place. The paramount goal of the universal service regime is, and must remain, *universal service*.

II. HIGH-COST SUPPORT IS NEEDED TO ENSURE UNIVERSAL SERVICE

These same policymakers that have emphasized the importance of universal service have also consistently recognized that carriers will not deploy and maintain these networks without sufficient universal service support. Carriers serving high-cost areas will play a key role in providing the advanced communications of the 21st century, but they cannot do so at comparable rates, as required by the Act, unless they receive additional funding. Several important factors work in concert to increase significantly the costs of infrastructure deployment in some parts of our country, which are referred to as "high-cost" areas. In light of these extraordinary costs, carriers face severe impediments in providing affordable universal service in high-cost areas.

[15] 152 Cong Rec S 9863 (Sept. 21, 2006).

[16] 152 Cong Rec S 9623 (Sept. 14, 2006).

Absent sufficient support, therefore, the Act's universal service goals could not be achieved and the great benefits of ubiquitous service would be forfeited.

The cost of providing telecommunications service varies significantly depending on population density, the distance over which infrastructure must be deployed, topography, and socioeconomic conditions.[17] First, a large part of the cost of a telecommunications network is shared and subject to significant economies of density and/or scale. As the FCC has noted repeatedly, "a lower population density generally indicates a higher cost area."[18] The National Exchange Carriers Association ("NECA") has estimated that as of 2000, the average household density in exchanges served by rural carriers was 5.95 households per square mile, whereas exchanges served by non-rural LECs had an average household density almost ten times as high, at 52.34 households per square mile.[19] These distinctions result in significant variation in the cost of deploying facilities in rural and other high-cost areas, on the one hand, and most cities and suburban areas, on the other.

As in other networked industries, the fixed costs associated with the provision of telecommunications are generally high in comparison to the incremental (marginal) costs. This means that in areas where there are fewer consumers, each customer must bear a higher portion of the network's fixed cost. Thus, it is not surprising that in a recent report, the Government Accountability Office ("GAO") found that "[t]he most frequently cited cost factor affecting

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[17] This is true for all technologies, although the actual investments needed and the relative efficiencies of different technologies may differ from place to place.

[18] *Federal-State Joint Board on Universal Service; North Carolina RSA 3 Cellular Telephone Company; Petition for Designation as an Eligible Telecommunications Carrier in the State of North Carolina*, CC Docket No. 96-45, Order, __ FCC Rcd ____ ¶ 23 (rel. Aug. 14, 2006).

[19] *See* Victor Glass, *NECA Rural Broadband Cost Study: Summary of Results* at 6 (June 21, 2000) ("*NECA Study*").

broadband deployment was the population density of a market," and that "the cost of building a broadband infrastructure in areas where people live farther apart is much higher than building infrastructure to serve the same number of people in a more urban setting."[20]

Second, sparsely settled areas will also result in higher costs because facilities will need to be constructed over far longer distances to reach end users. The distance between end users and the need to aggregate a critical mass of traffic in a switch together often necessitate the use of particularly long loops, increasing costs dramatically. Accordingly, the Commission has stated that "for universal service purposes ... cost differences caused by differing loop lengths are the most significant cost factor."[21]

Third, the topography of an area can also make it difficult to provide affordable service by making it more costly to deploy networks (whether wired or wireless), as the FCC has also noted.[22] The GAO found that "terrain was also frequently cited as a factor affecting broadband deployment decisions," because "infrastructure build-out can be difficult in mountainous and forested areas because these areas may be difficult to reach or difficult on which to deploy the required equipment."[23]

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[20] GAO, *Broadband Deployment Is Extensive throughout the United States, but It Is Difficult to Assess the Extent of Deployment Gaps in Rural Areas* at 19 (May 2006) ("*GAO Report*").

[21] *Federal-State Joint Board on Universal Service (Forward-Looking Mechanism for High Cost Support for Non-Rural LECs)*, CC Docket No. 96-45, Fifth Report & Order, 13 FCC Rcd 21,323, 21,355 ¶ 75 (1998)

[22] *See, e.g., Access Charge Reform*, 11 FCC Rcd 21354, 21370 ¶ 28 (1997).

[23] *GAO Report* at 19. Topographical concerns also impact the costs of terrestrial wireless providers, "because some wireless technologies require ... an unobstructed pathway—with no mountains, trees, or buildings—from the transmission site to the reception devices at users' premises," and even satellite communications, because hills and trees "can obstruct a satellite's signal." *Id.*

Fourth, socioeconomic conditions can also impact the economics of network deployment. For example, serving a pervasively low-income area can hinder cost recovery in the aggregate even if most customers can afford basic service (e.g., through Lifeline service) for several reasons. Penetration rates may be lower even with low-income support because potential customers face significant demands on their limited resources. Default rates are likely to be higher, which also is likely to increase costs (operating capital requirements and interest expense). Finally, because carriers typically provision basic service as well as advanced "vertical features" and high-capacity service over a single copper loop, providers in low-income areas may be hampered in efforts to make necessary upgrades that might, in a high-income area, have been funded by revenues associated with these additional services. Factors such as these will present challenges to providers even in the absence of the problems described above.

III. ANY HIGH COST DISTRIBUTION SYSTEM MUST FOLLOW SEVERAL CORE PRINCIPLES

Where factors such as those described in Section II above raise the cost of providing service above consumers' willingness or ability to pay for service, markets are unlikely to meet federal policy goals regarding universal service. Firms generally will not provide service where it is not economically viable to do so. Section 254 reflects Congress's determination that ubiquitous communications offerings are essential to the public good, however, and must be pursued *notwithstanding* the economic hurdles posed in high-cost areas. Therefore, the Joint Board and FCC are charged with the responsibility of providing adequate support to ensure universal service in high-cost areas.[24] Moreover, absent enough support, it is likely that even

[24] 47 U.S.C. § 254.

where service is available, competitive firms would charge prices that were higher than those prevailing in lower-cost areas to reflect cost differences.

Historically, support for universal service has been generated through carrier-of-last-resort obligations and implicit subsidies.[25] For the most part, the incumbent local exchange carrier (ILEC) in each area of the country has been required to provide service at a regulated rate to any requesting customer. When the service is being sold below cost, the ILEC has been required to look to its other customers for compensation. This has been accomplished in practice through several mechanisms, among them: (1) rate averaging across high and low-cost areas; (2) higher rates for some classes of customers, such as business customers; and (3) high regulated intercarrier compensation rates, largely in the form of interstate and intrastate access charges. Finally, various explicit universal service support mechanisms have evolved and grown over time to further compensate ILECs for providing service to customers in high-cost areas at rates that do not cover the cost of service.[26]

Competition has grown rapidly in markets served by ILECs since 1996, making the implicit subsidies for universal service tenuous and, ultimately, unsustainable. For example, rate averaging and higher rates to business customers establish price umbrellas under which competitors not subject to carrier of last resort obligations can target the business customers paying inflated prices. Consequently, when regulators force ILECs to overcharge some customers to subsidize affordable service for others, they facilitate uneconomic bypass of the ILEC network due to economically inefficient pricing. In addition, technological change is affecting universal service support by changing the way supported services are delivered and,

[25] *E.g.*, Jonathan E. Nuechterlein & Philip J. Weiser, *Digital Crossroads* 333-56 (2004).

[26] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report & Order, 12 FCC Rcd 8776 (1997) (*Universal Service First Report & Order*).

potentially, the costs of providing service in high-cost areas. The Commission, in coordination with the Board, consequently has undertaken reform of its universal service support mechanisms. The Public Notice is a significant step in this endeavor because it raises a number of important questions about the framework for funding universal service in competitive markets and in the face of technological change.

Congress recognized the impact competition would have on the regulation and implicit subsidies that have traditionally been used to guarantee universal service while rejecting disparities in service to high-cost areas. Section 254 establishes a universal service funding mechanism to achieve its objective of ensuring the availability of high-quality, affordable service at comparable rates in all parts of our country. This provision requires that

> [c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."[27]

In considering reform, the Board and the Commission must be sure to live up to this challenging, yet important, mandate.

The Board's evaluation of auctions as a possible mechanism for distributing high-cost support will be a useful exercise without regard to any possible conclusions for or against auctions. The analysis itself has important benefits at this time. In fact, it is useful to return occasionally to first principles and consider the reasons for universal service support. This is particularly the case when competition and technological change have the potential to significantly alter the purposes and economics of high-cost support, which is true today. For

[27] 47 U.S.C. § 254(b).

example, as USTelecom has pointed out, multiple ETCs and lax eligibility requirements have harmed support for high-cost areas.

The Public Notice raises many important questions and generally returns to first principles to evaluate possible changes to high-cost support. In this endeavor, USTelecom highlights several principles that are essential to any system of high-cost support: (a) high-cost support must preserve the economic viability of critical networks; (b) supported networks should be required to provide affordable service to all consumers, including those it is costly to serve, at rates comparable to those in urban areas, and to those in the rest of the country; and (c) high-cost support must be predictable, sufficient, and sustainable to benefit consumers.

A. High-Cost Support Must Preserve the Economic Viability of Critical Networks

The universal service objective is fundamentally about ensuring that networks are built in high-cost areas, typically in the rural parts of our country. Affordable, high-quality services cannot be deployed in the absence of critical infrastructure, and the high costs associated with hard-to-serve areas flow largely from the investments needed to deploy that critical infrastructure. Moreover, networks are engineered for peak usage, so support must remain consistent even during periods when the number of customers or lines declines. This is particularly true with respect to the network components that are shared among a number of high-cost lines. If support is lost on some, but not all, of the lines then the common infrastructure could also become unsustainable. Therefore, high-cost support must, ultimately, be directed at recovering the cost of deploying the networks and ensuring that they remain viable on an ongoing basis even in the face of competition. The Joint Board should also recommend steps to facilitate such high-cost support by encouraging efficiency in both supported networks and the administration of the high-cost support mechanism itself.

B. Networks Should Be Able to Provide Quality Services to All Consumers in Supported Areas, So that Consumers In All Regions of the Nation Have Access to Comparable Services at Comparable Rates

It is important that all parts of the country are connected, and that we do not leave behind high-cost areas, many of which are not currently served by cable or wireless providers. It is equally important that basic telecommunications service be affordable, and comparably-priced, throughout the country. Like national defense, law and order, roads and electricity, telecommunications is basic infrastructure upon which we should all be able to rely. As a society, we all benefit from having all parts of our country connected and integrated into our economy. Therefore, high-cost support must continue to flow to those providers that are ensuring the availability of service throughout supported areas, and in all parts of our country.

It is vitally important that high-cost support mechanisms remain focused on the universal service objective; we must not allow other concerns to stand in the way of efficiently and effectively ensuring universal service. For example, we must not spread support among multiple providers with overlapping networks in such a way as to make continued investment and operation infeasible for the networks serving as carriers of last resort in some areas. Otherwise, we risk losing ubiquitous availability of affordable, high-quality telecommunications service. Stated another way, where one network cannot provide the service we desire without support, we must be careful as a society before we provide support to one or more additional networks in the same area (or a part thereof).[28]

[28] *See, e.g.*, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommend Decision, 19 FCC Rcd 4257, 4317 (2004) (*Joint Board ETC Designation Recommendation*) (separate statement of Commissioner Kevin J. Martin).

C. Support Must Be Predictable, Sufficient, and Sustainable to Benefit All Customers.

Finally, high-cost support must be reliable for companies and investors to make the critical network investments that are needed to ensure universal service for all customers. Those investments are *sunk*—once made, they cannot be transferred to another location or a different use. Therefore, investors will need reasonable assurances that they will be able to recover the economic cost of their investments. Otherwise, they will choose less risky investments or demand greater returns, and the interest expense for telecommunications investment will be increased, making it difficult to efficiently and effectively guarantee universal service for all customers. Accordingly, high-cost support levels should be used to encourage continued investment in and rehabilitation of high-cost study area infrastructure and help recover the actual or embedded costs of such networks. Moreover, to provide reasonable assurances to investors, it is important that current recipients not qualifying for support in the future (for whatever reason) should be held harmless during a reasonable transition period. Otherwise, customers will suffer from higher prices and/or reduced availability of high-quality service.

IV. THE CURRENT FRAMEWORK FOR HIGH-COST SUPPORT IS BEING STRAINED BY FLAWED DISTRIBUTION POLICIES

There are several ways in which the current universal service framework is being strained, and support for critical networks is eroding. First, regulatory asymmetries are interfering with competition, which harms network efficiency and increases costs for everybody. Second, the implicit subsidies used to support service in high-cost areas are at risk. Finally, the current system supports multiple networks in areas where market-based competition cannot even support a single network and allows for the possibility of sending high-cost support payments to competitors that do not even serve the high-cost lines for which support is intended, which

accentuates the harm to competition. The result is more pressure on high-cost support mechanisms and, ultimately, risk to universal service itself.

Gaming Opportunities Abound Today. Only ILECs are required to provide service as carriers of last resort in all areas, and to provide service substantially below cost. Competitors can, and often do, avoid serving some of the highest-cost parts of ILEC service territories. The carrier of last resort, however, often must provide service in the highest-cost areas, and do so at rates (far) below cost. Moreover, the carrier of last resort generally does not have adequate pricing flexibility to respond to competition and risks losing customers upon which it is forced to rely for implicit subsidies. Competitors can serve those customers without having to charge higher rates to generate implicit subsidies to cover the costs associated with being a carrier of last resort, which gives those competitors artificial competitive advantages. Accordingly, as competitors win customers, the ILEC will have increasingly higher average costs even if it is the most efficient provider in the market because of its carrier-of-last resort obligations. Over time, this could leave the ILEC with only the most costly areas to serve, which will drive up the demand on the high-cost fund. This is not to say that competitors should be required to serve all areas, much less serve areas at below-cost rates. Rather, the public policy imperative that flows from asymmetric competition and regulation is that high-cost service support must be directed in the first instance at preserving universal service support instead of facilitating competition *per se*.

Current High-Cost Support Mechanisms Allow for the Possibility that Competitive Recipients of High-Cost Support Can Gain Additional Competitive Advantages, Further Interfering with Market-Based Competition and Increasing Pressure on the High-Cost Fund. Current high-cost distribution policies allow for the possibility of additional gaming opportunities for competitive eligible telecommunications carriers (CETCs) by giving support to

competitors that do not incur the costs associated with being a carrier of last resort. In some circumstances, the CETC may be able to avoid serving the highest-cost areas while still receiving high-cost support. When this happens, the CETC will gain an additional competitive advantage above and beyond the gains from simply avoiding high-cost areas. This disparity further interferes with competition and, over time, consumers will be harmed.

The policy and rules that provide CETCs with high-cost support even where they do not serve all of the high-cost areas for which support is provided also strains our system of high-cost support. The increased pressure on high-cost funding comes from: (1) increasing the number of networks supported by society; and (2) increasing the amount of funding needed to support the true carriers-of-last resort that serve all of the high-cost areas. In sum, current policies for high-cost support encourage multiple carriers of last resort in areas that cannot sustain a single such carrier in the absence of high-cost support. This is putting undue pressure on the high-cost fund and, thereby, threatening the long-term sustainability of universal service.

V. ALTERNATIVE MECHANISMS MAY BE USEFUL BUT SHOULD BE ANALYZED CAREFULLY

The fundamental goal of high-cost support is to ensure the availability of affordable service from a carrier of last resort in areas where high costs prevent the delivery of affordable service through market-based competition. Various alternative mechanisms for distributing high-cost support may be more or less effective at achieving this fundamental goal depending on how they are implemented. Indeed, as we explain in this section, the critical question may be how well a particular mechanism is implemented.

No matter which high-cost support mechanism is chosen, we must not be distracted by goals other than universal service; the sole question is which mechanism will best provide for

ubiquitous, high-quality, affordable service. *If, for example, promoting a diversity of providers* interferes with achieving the universal service objective, this must be acknowledged and universal service should take precedence.

It is also important that we achieve universal service without excessive administrative or regulatory cost. Stated another way, we must not allow "the perfect to be the enemy of the good." Therefore, the analysis of which support mechanism would be the most effective must weigh the substantial costs involved in changing the distribution mechanism from our current system to an alternative against any benefits of an alternative mechanism. It could be that one mechanism is marginally better than others at calculating the precise amount of high-cost support that is needed to achieve universal service. That mechanism may require excessive administrative oversight, or it may entail costly operational changes, either one of which could easily overwhelm any advantages the system offers in increased precision. In such a case, the better course would be to avoid the perfect system in favor of one that is less burdensome.

As the Joint Board evaluates the possibility of using auctions (or any alternative distribution mechanism) to calculate high-cost support, it must keep in mind that how a mechanism is implemented is critical to the results that can be expected. There are at least five ways in which an alternative distribution mechanism could produce substantially different results depending on implementation.

1. Rural infrastructure could be stronger or weaker depending on how an alternative distribution mechanism is implemented. Rural infrastructure could suffer if the support for critical telecommunications infrastructure in rural areas is diffused even further than today, so that no network serving a high-cost area receives adequate funding to make up the difference between market-based revenue and its cost of providing service. Conversely, rural infrastructure

could be strengthened if an alternative distribution mechanism concentrated high-cost support so as to ensure that critical networks actually received the full amount of support they need to deliver services where revenues do not cover the costs of service.

2. Services could be more or less affordable (to customers of supported services, or to other customers served by the same providers) depending on how an alternative distribution mechanism is implemented. An alternative mechanism could facilitate affordability in high-cost areas if supported providers received additional needed funding, and in lower-cost areas through market-based price reductions. Conversely, an alternative mechanism could harm affordability if it reduced the amount of support available to a provider, which would then need to raise prices on high-cost lines and/or seek additional support from its other customers (to the extent permitted by competition).

3. The cost of support (size of the fund) could be greater or lesser depending on how an alternative distribution mechanism is implemented. The cost of support could be higher than today if an alternative mechanism was less efficient, if it supported additional providers and/or services, or if it provided more support for covered services to existing recipients. On the other hand, an alternative mechanism could reduce the overall cost of support by supporting fewer providers or distributing less support (for example by requiring providers to rely on support from other customers or additional revenue streams to the extent permitted by competition).

4. The disruption of a major change in support mechanism could be greater or lesser than the benefits depending on how an alternative distribution mechanism is implemented. It may be possible to fundamentally change the mechanism for distributing high cost support without major disruption through transition mechanisms or rules that rely to the extent possible on current processes. Conversely, a sweeping restructuring of high-cost support could

overwhelm any benefits from a more efficient and effective distribution mechanism if it is accompanied by substantial litigation, uncertainty, and new administrative costs.

5. The stranded investment problem could be manageable or unmanageable depending on how an alternative distribution mechanism is implemented. Historically, ILECs provided service in high-cost areas in keeping with regulatory mandates and price controls, and they continue to do so today. Consequently, many (if not all) ILECs have made investments that still haven't been recouped. Should they be deprived of a reasonable opportunity to cover those costs, the Commission and other regulators would be faced with having to compensate the ILECs for their stranded investments. The magnitude of this problem could be increased through the implementation of an alternative high-cost distribution mechanism that displaced many ILECs without compensation.[29] Conversely, an alternative distribution mechanism could make the stranded investment problem more manageable if it established a clear path toward determining and paying the amount of compensation required for stranded investments.

In sum, the Joint Board must consider the relative merits and disadvantages of an alternative distribution mechanism carefully. In particular, the evaluation must not be based on theory alone. Instead, the Joint Board must develop a clear understanding of how an alternative distribution mechanism would be implemented, and how it would operate in practice. Then, the Joint Board should measure the anticipated results from a new mechanism against current high-cost support, together with the administrative and transaction costs of switching that would be incurred by stakeholders, and society as a whole.

[29] The loss of complementary service areas could also drive up the cost of serving the areas the ILEC retained by removing contributions to the common costs associated with shared network infrastructure.

VI. THE PUBLIC NOTICE RAISES MANY IMPORTANT QUESTIONS, AND THERE ARE MANY OTHER CRITICAL QUESTIONS TO BE ANSWERED

Since 1997, the universal service regime has been structured around the fundamental choices the Commission made when first implementing section 254. The Public Notice revisits many, or even most, of those choices, as might be expected when one is considering fundamental changes to nature of the high-cost support program. By USTelecom's count, there are at least 59 separate questions presented in the Public Notice, most of which are broad and open-ended. In addition, the Discussion Proposal attached to the Public Notice contained at least 36 discrete decisions, each of which implicitly answered several major questions. In both cases, however, many crucial issues remain unaddressed. USTelecom supports the Board's interest in reform, and thus takes this opportunity to highlight other key questions that must be answered as policymakers contemplate new frameworks like those described in the Public Notice.

Administrative Costs. First, the Board must examine carefully the administrative costs associated with the various possible frameworks for high-cost relief. These costs represent "dead-weight" losses that benefit neither carriers nor consumers. Even if a particular regime would otherwise improve upon the current framework, it should be rejected if the associated administrative costs outweigh the relative benefits. Thus, USTelecom urges the Board to consider what new costs an auction-based system would impose on carriers and consumers, and how those costs would compare to those associated with the present regime. The Board should also consider the relative costs to USAC and the Commission in administering support under any new framework. For example, the Discussion Proposal contemplates post-auction negotiation with the lowest bidder, and permits the Commission ultimately to contract with the runner-up if an acceptable contract is not negotiated with the low bidder within 90 days. Would the transaction costs associated with these negotiations undermine – or eviscerate – the

administrative advantages of the auction process? Further, the Board must assess the costs that will be engendered by the litigation that will inevitably follow any regulatory shift, and by the market uncertainty that will accompany that litigation. Indeed, capital markets will respond to uncertainty by requiring compensation for the additional risk, which will increase the costs of financing the deployment of modern telecommunications networks. The Board should also consider the considerable litigation costs that will surely arise if, per the Discussion Proposal, the Commission negotiated a contract with a runner-up notwithstanding the low bidder's desire to continue negotiations.

Interaction with Existing Regulatory Framework. Second, the Board must address various issues pertaining to the relationship between the USF distribution mechanism and other state and federal requirements. One significant question is whether auctions are compatible with the concept of rate-of-return regulation. If not, will the state-law obligations of rate-of-return carriers handicap those carriers in the auction process? Are federally administered auctions fundamentally consistent with *any* state regulation of retail rates? Is an auctions approach consistent with the "carrier of last resort" obligation currently borne by most ILECs? If not, is there a legal means to ensure that a carrier that is priced out of a market through the auction mechanism will be relieved of that obligation? How would such a carrier be compensated for its stranded investment? How would the auction process be reconciled with "make-whole" programs such as the current Interstate Common Line Support mechanism and the "Restructure Mechanism" currently under consideration in conjunction with the Missoula Plan for Intercarrier Compensation? In addition, some ILECs are subject to pervasive rate regulation, while their retail competitors often are not. Can a fair and effective auction be designed in cases where only

one of the participants is subject to such regulation? Finally, is the auction process consistent with the statutory requirement that *all* ETCs be eligible to receive support?

Auction Design. Third, the Board must consider a host of questions relating to auction design. The Notice mentions several relevant issues, including the appropriate level of geographic generality at which to define service areas, the appropriate number of providers in a given area, and the degree to which support should remain constant among all providers in such an area. The Commission's experiences with the universal service regime and the spectrum auction process suggest myriad other questions as well. For example, the Board must consider who will be eligible to bid. Will the auction for a particular geographic area be limited to carriers already designated as ETCs throughout the service area, or will new entrants be eligible as well? Should eligibility standards be relaxed (or heightened) in areas unlikely to invite entry by more than one provider? Should preferences be offered to specific entities (*e.g.*, rural telephone companies, small businesses, or entities that propose higher service quality standards)? If so, will they be subject to additional regulatory requirements?

The Board must also consider various "auction design" issues surrounding the selection of winning bids. Would the auction employ multiple rounds, as recent spectrum auctions have, to facilitate optimal bidding strategy? If so, what rules would govern participants' bidding activity, bid withdrawals, and the termination of the auction? Will bidders be entitled to capitalize on economies of scale by submitting contingent bids that presuppose the carrier's ability to service multiple contiguous geographic areas? Will they be entitled to account for discounts offered to customers who purchase bundled products?

The Board will also need to address appropriate safeguards against bidding that results in inadequate support. How will the Commission prevent strategic bidding designed to "game" the

auction process? In particular, how will the appropriate price be established when regulation forces some providers to offer service substantially below cost? How will the Commission ensure that a winning bidder can, in fact, meet carrier of last resort obligations? The winning bid will generally lead to support levels lower than the levels at which other providers believed that provision of service was feasible. How, then, will service be preserved and advanced if the winning bidder has misjudged, and no carrier is able to provide service at the auction-derived support level? Can the Commission ensure that the process will protect against bidding designed solely to drive the bidder's competitors out of the market – irrespective of whether the bidder could actually provide service at the bid level in the long term? Would the Commission establish minimum permissible bids to preclude strategic or ill-informed bids that might result in inadequate support? If so, how will these lower limits be ascertained?

In the event the Board proposes a "single-provider" auction model, it must also consider the appropriate time period during which the winner would receive support which, in turn, must dictate the frequency of required auctions. Telecommunications is an extremely capital-intensive enterprise, and various network elements have differing useful lives – almost guaranteeing that a carrier that loses its entitlement to provide service will be left with significant stranded investment. This problem is likely to be especially problematic for long-standing ILECs, which constructed facilities under a regime that guaranteed a return on their investment but in many areas required provision of service at below-cost rates. How would the auction process guarantee an adequate return on this investment?

Post-Auction Service Obligations. Fourth, the Board must address clearly issues surrounding quality of service obligations and the enforcement thereof. Parties cannot bid efficiently without a clear understanding of their post-auction obligations, and the bidding

process will be fundamentally flawed if auction participants have differing interpretations of those obligations. Thus, the Board must describe the carrier's actual service obligations as specifically as possible. What services will be supported, and what level of quality is expected? What is the scope of the service obligation? Will all parties supporting service at the auction-derived rate be subject to carrier of last resort obligations? Will such obligations endure as market conditions evolve or fall away over time? Whatever the obligations are, how will the Commission monitor performance? Will it rely on the current enforcement process?

Finally, the Board must be clear about what penalties will be imposed in the event a winning bidder defaults on its service obligations after the auction; absent sufficient penalties, under-funded entrants will be able to preclude the service by long-standing providers while assessing whether or not participation in the market will be feasible in the long term. This approach is a recipe for disaster, and the Board must carefully consider appropriate deterrents.

* * *

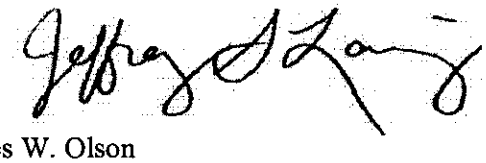
In posing these additional questions, USTelecom does not suggest that reform is impossible, or even ill-advised. Rather, USTelecom stresses here that a broad restructuring of the high-cost mechanism should not be undertaken lightly. The universal service regime has evolved over many decades, and fundamental reform will require careful considerations of many difficult issues. Careful deliberation now will help prevent the unforeseen consequences and protracted litigation that too often result from hurried decision-making, and will benefit carriers, consumers, and the public interest alike.

VII. CONCLUSION

As the Board and the Commission consider systemic reform of the universal service distribution mechanism, they should be guided by the fundamental goals of the support regime, and remain mindful of its great successes thus far. Alternative high-cost support mechanisms may be useful but should be analyzed carefully. The Public Notice raises many important questions, and there are many other critical questions to be answered.

Respectfully submitted,

UNITED STATES TELECOM ASSOCIATION

By: 

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