RECEIVED

OCT 12 2006

Federal Communications Commission
Office of the Secretary

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

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

RECEIVED

OCT 12 2006

Federal Communications Commission
Office of the Secretary

TO: Federal-State Joint Board on Universal Service

COMMENTS OF THE WESTERN TELECOMMUNICATIONS ALLIANCE

Gerard J. Duffy
Blooston, Mordkofsky, Dickens,
Duffy & Prendergast
2120 L Street, NW (Suite 300)
Washington, DC 20037
Phone: (202) 659-0830
Facsimile: (202) 828-5568
Email: gjd@bloostonlaw.com

Dated: October 10, 2006

No. of Copies rec'd 0
List ABCDE

Table of Contents

Summary

The Western Telecommunications Alliance (WTA) has attempted to evaluate the possible use of reverse auctions for distributing federal Universal Service Fund (USF) support to eligible telecommunications carriers (ETCs). At this time, concerns about the adverse impact of reverse auctions upon essential rural infrastructure investment, as well as numerous questions regarding the design and conduct of fair auctions, lead WTA to support other options for controlling the size and growth of the federal USF.

All such options must be evaluated in terms of their ability to satisfy the Section 254 provisions regarding quality services at affordable rates, access to advanced telecommunications and information services, reasonable comparability of urban and rural services and rates, and specific, predictable and sufficient support. The critical link here is investment, for predictable and sufficient federal USF support will enable investment in the rural telecommunications infrastructure necessary to furnish rural residents and businesses with quality services, affordable rates, reasonably comparable services, and access to advanced services.

Rural telephone companies have a proven record of investment and compliance with these universal service requirements, and remain the entities most likely to bring advanced services to rural areas. During the past decade, transfers of former access revenues into federal USF mechanisms have made federal USF revenues the predominant revenue stream for many rural telephone companies. Unfortunately, reverse auctions would subject these crucial federal USF revenues to uncertainty and instability that could preclude the assurances of cost recovery and loan repayment necessary to obtain financing and approvals for significant rural infrastructure investments. Moreover, even

for winning bidders, the depreciation lives of most rural switches and lines are so much longer than the likely terms of reverse auctions that investment cycles would be disrupted.

In addition, reverse auctions will be extremely difficult and complicated to design and administer. There are numerous unanswered questions regarding the composition of bid proposals, the treatment of existing services and rate plans, the development of comparable service quality standards for different networks and technologies, the impact of different regulatory requirements and costs, the handling of different service areas, the regulation of losing bidders, the participation of large and small carriers, the use of non-price bid evaluation factors, the negotiation of contracts, the prevention of gaming, and the enforcement of auction requirements and conditions throughout the auction term. Moreover, the initial resolution of these issues could give rise to additional problems and dangers, or entail unintended and unwanted consequences.

WTA believes that a more investment-friendly, effective and efficient way to control the size and growth of the USF is to re-evaluate the relationship between wireline and wireless services, and de-couple the portable USF support received by competitive ETCs (CETCs) from the "per-line" support received by incumbent local exchange carriers (ILECs). This can be accomplished: (1) by providing support to CETCs on the basis of the actual and properly allocated costs of their own rural operations; or (2) by providing support to CETCs only on the basis of the per-line high-cost loop support received by the ILEC serving the same area, and eliminating the portability of Local Switching Support and of present and future access recovery mechanisms (such as Interstate Common Line Support) transferred into the USF.

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

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

TO: Federal-State Joint Board on Universal Service

COMMENTS OF THE WESTERN TELECOMMUNICATIONS ALLIANCE

The Western Telecommunications Alliance (WTA) submits its comments regarding the possible use of reverse auctions to determine high cost universal service funding to eligible telecommunications carriers (ETCs) pursuant to Section 254 of the Communications Act of 1934, as amended (the Act). These comments are filed in response to the Public Notice (Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support), FCC 06J-1, released August 11, 2006.

WTA understands that there are pressures from a variety of sources to control the size and growth rate of the federal Universal Service Fund (USF). However, in evaluating various options for doing so, the Joint Board and Commission need to ensure that the option they choose enables the federal USF mechanism to meet the statutory universal service principles and obligations regarding quality services at affordable rates [47 U.S.C. §254(b)(1)], access to advanced telecommunications and information services in all regions [47 U.S.C. §254(b)(2)], reasonable comparability of rural services and rates

vis-à-vis those in urban areas [47 U.S.C. §254(b)(3)], and specific, predictable and sufficient support [47 U.S.C. §§254(b)(5) and 254(d)].

WTA believes that the critical task of the federal USF regarding these statutory requirements is to encourage and facilitate investment in the telecommunications infrastructure necessary to permit rural residents to participate fully in the economy and society of the 21st Century. This is particularly true with respect to rural telephone companies, which have a proven record of investment and service in their rural service areas, and which offer the best hope for continued progress in the provision of advanced telecommunications and information services to rural residents. After a decade of transfers of access revenues into USF mechanisms, federal USF revenues have become the predominant revenue stream for most rural telephone companies. A predictable and sufficient federal USF is now absolutely essential for rural telephone companies to furnish the assurances of cost recovery and loan repayment necessary to convince their lenders, investors, vendors, owners and directors to approve the rural investment projects needed to serve their rural communities and residents.

Hence, the pivotal consideration with respect to reverse USF auctions is their impact upon investment in rural infrastructure. Even if reverse USF auctions are able to produce some sustainable reductions in federal USF size or growth, there is great danger that such benefits may be dwarfed by the adverse impact of such auctions upon rural investment. By rendering it possible that a rural carrier might lose some or all of its crucial federal USF revenue stream for a term of 10 years or so, the uncertainty and instability introduced by reverse auctions is likely to cause lenders to demand much higher interest rates, impose more stringent terms, or refuse to make loans for rural

infrastructure investment. This would make it very difficult or impossible for rural telephone companies to continue to make essential infrastructure investments needed to serve their customers. Moreover, even where a rural carrier wins a reverse auction, its investment financing and incentives may still be impaired significantly because the depreciation lives of most rural network facilities are considerably longer than the likely terms of auctions.

In addition, reverse auctions will be extremely difficult and complicated to design and administer. Unlike spectrum auctions and eBay auctions, participants in reverse USF auctions are not likely to be bidding for the same readily ascertainable items. Rather, they will be "bidding" to receive differing levels of proposed USF support for differing quantities, qualities and packages of supported telecommunications services provided over differing types and configurations of facilities at differing rates and rate plans. Moreover, the various service providers that might participate in reverse USF auctions serve a variety of differing service areas subject to significantly different regulatory requirements and pursuant to significantly different technologies, financial structures and business plans.

In order to reduce the potential for gamesmanship, the Commission would need to: (1) establish very detailed USF service, quality and pricing standards to make the auctioned "item" more uniform; (2) negotiate, enter into and enforce a detailed contract with each auction winner to ensure that it provides all of the service, quality, pricing and investment that it proposed in connection with its winning USF bid; and/or (3) employ qualitative factors in addition to bid prices in selecting auction winners. However, the design and implementation of these measures would be very challenging and complex,

and could give rise to additional problems and dangers, or entail unintended and unwanted consequences.

WTA believes that there are more investment-friendly, effective and efficient ways to control the size and growth of the USF. The principal steps that need to be taken are the re-evaluation of the relationships between various services (especially the relationship between wireline and wireless services) and the limitation of the multiplier effect of "access reform" upon the size and growth of the USF by de-coupling the portable USF support received by competitive ETCs (CETCs) from the "per-line" support received by rural telephone companies. This can be accomplished: (1) by providing support to CETCs on the basis of the actual and properly allocated costs of their own rural operations; or (2) by providing support to CETCs only on the basis of the per-line high-cost loop support received by the incumbent local exchange carrier (ILEC) serving the same area, and eliminating the portability of Local Switching support (LSS) and of present and future access recovery mechanisms [such as Interstate Common Line Support (ICLS)] transferred into the USF.

I

The Western Telecommunications Alliance

The Western Telecommunications Alliance is a trade association that represents approximately 250 rural telephone companies operating west of the Mississippi River.

WTA members are generally small independent local exchange carriers ("ILECs") serving sparsely populated rural areas. Most members serve less than 3,000 access lines overall, and less than 500 access lines per exchange. Most members also

generate revenues much smaller than the national telephone industry average, and presently rely upon federal USF dollars for approximately 25-to-50 percent of their revenues.

WTA members serve remote and rugged areas where loop, transport and switching costs per customer are much higher than in urban and suburban America. Their primary service areas are comprised of sparsely populated farming and ranching regions, isolated mountain and desert communities, and Native American reservations. In many of these areas, the WTA member not only is the carrier of last resort, but also is the sole telecommunications provider ever to show a sustained commitment to invest in and serve the area.

WTA members are highly diverse. They did not develop along a common Bell System model, but rather employ a variety of network designs, equipment types and organizational structures. They must construct, operate and maintain their networks under conditions of climate and terrain ranging from the deserts of Arizona to the rain forests of Hawaii to the frozen tundra of Alaska, and from the valleys of Oregon to the plains of Kansas to the mountains of Wyoming.

Predictable and sufficient cost recovery is essential to WTA members if they are to continue investing in and operating telecommunications facilities in high-cost rural areas, while providing their rural communities and customers with quality and affordable services reasonably comparable to those available in urban areas. Therefore, WTA has found it necessary to participate in this and other proceedings that may affect federal high cost support and the economic development of rural areas.

II

Growth of Federal Universal Service Fund

In 1995, the federal USF was an approximately $750 million dollar program that helped rural telephone companies recover their above-average loop costs in order to keep local service rates at affordable levels in high-cost rural areas. By 2005, the federal USF was distributing approximately $6.52 billion[1] to rural and non-rural telephone companies, competitive local exchange carriers, wireless carriers, schools, libraries and rural health care facilities.

WTA recognizes that the federal USF cannot continue to grow at this pace, and that it needs to be stable, sufficient and sustainable on a long-term basis. However, before analyzing and evaluating reverse auctions and other options for controlling its growth, the specific manner in which the federal USF has grown should be noted.

First, the 1996 Act added two wholly new programs to the federal USF for the provision of telecommunications and Internet access services to schools, libraries and rural health care providers. The Schools and Libraries Program may distribute up to $2.25 billion per year, while the Rural Health Care Program may distribute up to $400 million. During 2005, the two programs distributed approximately $1.887 billion.[2]

Second, over the past decade, the Commission has transferred what is now approximately $2.294 billion per year of former access charge revenues for rural and non-rural telephone companies into federal USF mechanisms. During 2005, these USF mechanisms distributed $424.8 million in Local Switching Support (LSS), $1.178 billion in Interstate Common Line Support (ICLS), and $691 million in Interstate Access

[1] Source: Universal Service Administrative Company, *2005 Annual Report*, p. 7.
[2] *Id.*

Support (IAS).[3] It appears possible that further reductions in interstate and intrastate access charges and other intercarrier compensation may result in the transfer of an additional $2.0 billion or more of access revenues to some sort of non-access mechanism within the next few years.

Third, since 1999, wireless and other CETCs have been receiving rapidly increasing amounts of portable federal USF support. During 2005, this portable CETC support had grown to $638.5 million.[4]

WTA notes particularly the perverse multiplier effect of the interaction between: (a) the use of per-line USF support received by ILECs as the basis for calculating portable CETC support; and (b) the transfer of ILEC access cost recovery into the federal USF. Every time that the Commission transfers an additional $1.00 of an ILEC's access revenues into a USF mechanism, each CETC in the ILEC's service area gets a windfall of another $1.00 of portable support and the overall size of the federal USF grows by $2.00 to $6.00 (depending upon the number of CETCs in the ILEC's service area). This multiplier effect is responsible for a significant portion of past USF growth, and poses a substantial obstacle to future modifications of intercarrier compensation. As will be detailed below, WTA believes that the time is ripe to re-examine whether wireline and wireless services are complementary rather than competitive, and whether the principle of competitive neutrality really requires that wireless CETCs should receive portable USF on the basis of the costs and support of ILECs.

WTA further notes that the original USF mechanism for high-cost loops in rural areas has not grown very much during the past decade. When one subtracts the $2.294

[3] *Id.* at p. 39.
[4] *Id.* at p. 41.

billion transferred into the USF from access charges and the $638.5 million of portable USF support provided to CETCs from the aggregate $3.824 billion distributed by high-cost USF mechanisms during 2005[5], the remaining $892 million of estimated "original" high-cost loop support does not constitute a significant ten-year increase from its $750 million base in 1995.

In sum, rural telephone companies and their customers have not been the drivers of federal USF growth during the past decade. Rather, the E-rate program and "access charge reform" (which was strongly urged upon rural telephone companies by regulators and other telecommunications industry segments) were the largest factors, while portable support to CETCs has become the primary growth engine during recent years.

III

Standards for Evaluating USF Control Options

In evaluating various options for controlling the size and growth of the federal USF, the Joint Board and Commission need to ensure that the option they choose enables the federal USF mechanism to meet its statutory obligations: (1) to make available quality services at affordable rates, 47 U.S.C. §254(b)(1); (2) to give rural consumers access to services reasonably comparable to those provided in urban areas at reasonably comparable rates, 47 U.S.C. §254(b)(3); (3) to provide access to advanced telecommunications and information services in all regions of the Nation, 47 U.S.C. §254(b)(2); and (4) to be specific, predictable and sufficient, 47 U.S.C. §§254(b)(5) and 254(d).

[5] *Id.* at p. 7.

The key that links all four of these statutory requirements is the encouragement and facilitation of investment in rural telecommunications infrastructure. Whereas a specific, predictable and sufficient federal USF was very important when the 1996 Act was passed, it has subsequently become the single most important factor affecting the financing and incentives for rural infrastructure investment. As more and more of the former access revenue stream has been transferred into USF mechanisms, the federal USF has become the predominant revenue stream for most rural telephone companies, and now comprises 25-to-50 percent of the revenues of the typical WTA member. Stable and sufficient USF revenue streams are now absolutely essential to provision of the assurances of investment cost recovery and loan repayment necessary to convince lenders, investors, directors and owners to approve rural infrastructure investments.

In turn, substantial and continuing investments in additional and upgraded facilities and in new technologies are necessary to permit WTA members and other rural telephone companies to furnish their rural customers with quality services at affordable rates, to offer them advanced telecommunications and information services, and to give them access to telecommunications and information services reasonably comparable to those provided in urban areas at reasonably comparable rates.

WTA members and other rural telephone companies have a proven record of making reasonable and prudent investments in the rural telecommunications networks necessary to furnish the level and quality of services needed and desired by their rural customers. They have been in the forefront of upgrading their networks to install digital switches and soft switches, to implement Signaling System 7, to install fiber optic cable and digital subscriber line (DSL) capabilities, to bury lines to limit weather damage and

outages, to provide local or centralized equal access, to offer custom calling options, to comply with Emergency 911 (E-911) and Communications Assistance for Law Enforcement (CALEA) responsibilities, and to enable access to the Internet and information services. Rural telephone companies offer the best hope for continued progress in the provision of advanced telecommunications and information services to rural residents.

WTA notes that rural infrastructure investment does not benefit only rural telephone companies and their customers. Quality rural telephone networks also facilitate the operations and services of wireless carriers, Voice over Internet Protocol (VoIP) providers, and other telecommunications and information service providers. Wireline facilities have long been used by wireless carriers to connect their cell sites with each other, with their mobile telephone switching offices (MTSOs), and with the public switched telephone network (PSTN). Likewise, Vonage, Pulver.com and other VoIP providers have not been investing significantly in rural networks, and will continue to depend upon rural telephone facilities to handle their rural traffic.

Finally, WTA reminds the Joint Board and the Commission that the typical rural telephone company is the heart and soul of its community. Rural telephone companies are generally locally managed businesses that remain sensitive and respond flexibly to the telecommunications and other needs of their friends and neighbors. They provide attractive local jobs and job training, help recruit and retain other local businesses, support local civic and volunteer activities, assist local schools and students, and contribute to public health and safety and disaster recovery efforts. First and foremost, by furnishing state-of-the-art facilities and quality services, rural telephone companies

contribute significantly to the economic development of their service areas by enabling both business and residential customers to communicate instantaneously with business associates and potential customers throughout the world.

IV

Evaluation of Reverse Auction Option

Reverse USF auctions may reduce the size of the federal USF by limiting the number of USF recipients in ILEC service areas where there presently are one or more CETCs receiving the same per-line USF support as the ILEC. However, even if they are significant and sustainable, there is great danger that these potential reductions may be overshadowed or nullified by the disruptions and costs of reverse auctions. The uncertainty and instability that they introduce into the critical USF revenue stream are likely to have a very substantial adverse impact upon the investment financing, investment incentives and investment cycles of rural telephone companies, to the detriment of the service quality, affordable rates, reasonable urban-rural comparability and advanced services needed by rural customers. In addition, the complexities of designing reverse USF auctions will make it extremely difficult for regulators to conduct fair auctions and minimize gamesmanship without engaging in extremely detailed, onerous and expensive pre-auction and post-auction regulation.

A. Possible USF Size and Growth Reductions

By limiting the number of USF recipients to one or two per service area, reverse auctions may reduce USF outlays somewhat, at least initially. However, it is not clear how much of a reduction might be expected, or how long it might be sustained.

As of 2005, there were 1,435 ILEC study areas (1,349 rural and 86 non-rural) and 349 CETC study areas (189 rural and 160 non-rural) receiving USF support.[6] If reverse auctions limited USF recipients to one per study area, it would appear that approximately 349 ILEC or CETC study areas may not receive support for the term of an auction. If reverse auctions allowed as many as two USF recipients per study area, support to a lesser number of ILEC/CETC study areas (i.e., those where there are now 3 or more USF recipients) may be eliminated.

At least in the initial reverse auctions, it is also possible that some ILECs and/or CETCs will "bid" to receive USF support in amounts significantly less that they currently receive, in the hope of getting some future USF support (even if insufficient) rather than none at all. It is difficult to estimate how much of a reduction in the aggregate amount of USF support might result from this approach. However, if the reductions were substantial, they could cause the USF mechanism to fail to meet its statutory service quality, affordable rates, rural-urban comparability, advanced services and/or sufficiency responsibilities in various rural service areas. Moreover, if certain ILECs and/or CETCs that lose all USF support as the result of being losing bidders during one or more of the initial reverse auctions elect to leave a rural service area, it is possible that winning bidder(s) will increase their bids to or above current USF support levels once their competition weakens or disappears.

B. Impact upon Rural Infrastructure Investment

WTA believes that the crucial problem to be addressed in the evaluation of the reverse auction option is the likely adverse impact of such auctions upon rural investment financing, investment incentives and investment cycles.

---

[6] *Id.* at p. 8.

First, auctions would introduce major uncertainties and risks into a rural investment environment where certainty and stability are necessary. As indicated above, the transfer of almost $2.3 billion of access cost recovery into the federal USF mechanism during the past decade has made federal USF support the predominant revenue stream for most rural telephone companies. If such a large revenue stream of any company is eliminated or slashed precipitously by the loss of a reverse USF auction or any other cause, the entity will have few choices other filing for bankruptcy or engaging in a major restructure or reduction of its services and service quality, work force, expenditures and investment plans.

As the Joint Board and Commission are well aware, most rural telephone companies are relatively small entities with limited revenues and liquid assets, as well as limited access to capital markets. They generally must rely upon loans to finance significant infrastructure investment projects. Moreover, given that rural telephone companies generally serve high-cost rural areas with small customer bases and limited revenue potentials, their lenders and owners demand significant assurances of cost recovery and loan repayment before approving such investments.

If the reverse USF auction option is adopted, the possibility that a rural telephone company may lose all of its USF revenues (or be forced to agree to accept a substantial decrease in such revenues in order to "win" an auction) for ten or so years will make it virtually impossible for it to make such assurances. As a result, rural telecommunications investment loans will dry up or become prohibitively expensive, and many rural infrastructure investment projects will be rejected, cancelled or postponed.

Investment cut-backs will not just harm rural telephone companies. Rather, they will inflict substantial injury upon rural communities, businesses and residents. For starters, the excellent record of rural telephone companies in extending broadband facilities and services deeper and deeper into their networks will come to a screeching halt as investment loans dry up. Given that rural telephone companies offer the best hope for broadband deployment in Rural America during the foreseeable future,[7] this will leave many rural communities, businesses and residents without access to quality and affordable broadband facilities and services reasonably comparable to those in urban areas. Among other things, this will impair the economic development of the affected rural communities by making them less attractive locations for businesses and individuals that need ready access to the Internet and to high-speed data and information services.

Moreover, in addition to the general adverse impacts of an uncertain USF revenue stream, the incongruity between the lengthy depreciable lives of telecommunications equipment and the likely effective periods of reverse auctions will wreak havoc upon rural infrastructure investment financing, incentives and cycles.

The distinguishing characteristics of most telecommunications equipment are that it is expensive, durable and depreciated over substantial time periods. In CC Docket No. 98-137[8], the Commission mandated depreciation ranges for large ILECs for various telecommunications network facilities, including digital switches (12 to 18 years), digital

[7] Wireless carriers are not currently capable of providing bandwidth and broadband services equivalent to those of wireline carriers. Moreover, uncertain and unstable USF support will impair funding and reduce incentives for all carriers, wireline and wireless, to undertake substantial rural construction projects.

[8] *1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, Report and Order in CC Docket No. 98-137, Memorandum Opinion and Order in ASD 98-91, FCC 99-397, released December 30, 1999, at Appendix B. Whereas smaller ILECs are not subject to the Commission's depreciation prescription process, they generally use comparable depreciation lives.

Formatted: Font: Italic

Deleted: CITE (December 17, 1999).

circuit equipment (11 to 13 years), fiber cable (25 to 30 years), metallic aerial or buried cable (20 to 26 years), and metallic underground cable (25 to 30 years).

Given the lengthy cost recovery periods for such equipment, it is difficult to conceive how the lengths of the effective periods for reverse auctions could be set without exacerbating adverse impacts upon investment and investment cycles. If reverse auctions designate USF recipients for a relatively "short" period (e.g., 1-to-10 years), winning bidders are unlikely to obtain financing or to have incentive to invest in facilities and equipment having much longer depreciation periods. Since virtually all substantial elements of the telecommunications infrastructure have depreciation lives greater than 10 years (with most having much longer cost recovery periods), a "short" auction term can be expected to have a very negative impact upon rural investment.

Even if reverse auctions were to designate USF recipients for a relatively "long" period (e.g., 15-to-25 years), investment cycles would still be disrupted because: (1) many elements of rural networks have even longer depreciation periods; and (2) investment financing and incentives will decrease as the time remaining until the next auction grows shorter (*e.g.*, a carrier will become increasingly reluctant or unable to invest in a new digital switch with a 12-year depreciation period after Year 4 of a 15-year auction term). Moreover, once a winning bidder has invested in the facilities and services that it promised at the time of the auction, federal and state regulators would have little or no ability to require the bidder to invest in new technologies and services during the remainder of the auction term.

In other words, the determination of the effective term for a reverse auction appears to be a "lose-lose" choice between: (a) relatively "short" terms that would

discourage investment in virtually all telecommunications infrastructure; and (b) relatively "long" terms that might encourage some investment during the early years but then disrupt normal rural investment cycles by freezing technology and producing minimal investment for the remainder of the period.

In sum, by rendering uncertain and unstable the largest revenue stream of most rural telephone companies, the reverse auction option could have major adverse impacts upon investment financing, incentives and cycles throughout Rural America. This diminution of rural investment may entail significant costs in the long run as well as the short run, for it can saddle rural residents, businesses and other service providers with service, quality and economic losses from degenerating facilities, and may require expensive future catch-up efforts to make up for years of neglected maintenance and modernization.

C. Difficulty of Designing Fair Reverse USF Auctions

Reverse USF auctions will be very different from spectrum auctions[9] and eBay auctions wherein multiple entities value and bid for the same licenses or items. They will also be very different from subsidy auctions in Latin America, which have been employed primarily to select individual carriers to provide defined packages of first-time telecommunications services to previously unserved areas.

The contemplated reverse USF auctions will be far more complex, and far more difficult for regulators to design and conduct fairly. Rather than multiple entities bidding for the same object, reverse auctions will consist of multiple entities "bidding" to receive differing levels of proposed USF support for potentially differing quantities, qualities and

[9] In some spectrum auctions, the Commission has attempted to encourage participation by smaller businesses by designating smaller license areas and offering bid credits.

Formatted: Justified

bundled packages of supported telecommunications services provided over differing types and configurations of facilities at potentially differing rates and rate plans. And rather than multiple entities seeking the right and funding to serve a previously unserved area in which they have little or no prior investment, reverse USF auctions will consist of multiple existing service providers bidding for USF support to operate, upgrade and expand their existing networks and risking loss or devaluation of their substantial prior investments if they do not win the auction. Moreover, the various wireline telephone companies, wireless carriers, competitive local exchange carriers (CLECs), satellite carriers, VoIP providers and cable television companies that might participate in reverse USF auctions serve a variety of differing service areas subject to significantly different regulatory requirements, and operate pursuant to significantly different technologies, financial structures and business plans.

Will the Commission allow each bidder to propose a level of USF support for its own unique existing configuration of services, facilities and rates, and then try to make a choice among a virtual Tower of Babel of bids for different support for different configurations? Or will it specify a common set of services and rates which the winning bidder would be required to offer? Would this common set of services and rates be the same for all auctioned service areas, or be unique to each separate area? Would the set of services be: (a) an ideal set of desired services; (b) a "best practices" set of services; (c) an averaged set of services; or (d) a least common denominator set of services? Would such standard be determined on a national, state or local service area basis? How would the rates for a designated set of services be determined? Would rates be evaluated or adjusted on the basis of economic conditions within particular service areas, carrier size,

technology and/or affordability? Would winning bidders be required to modify or eliminate existing rates, rate plans and/or service packages? How would common or comparable service quality requirements be determined for services provided over different networks and technologies?

Also, the existing service providers likely to participate in reverse auctions serve very different areas that generally overlap only partially with one another, and that are subject to very different types and amounts of regulation. Rural and non-rural ILECs serve study areas, and are subject to substantial federal and state regulation (including, rate, service quality, and Carrier of Last Resort regulation). Wireless carriers serve a variety of large and small regions such as Metropolitan Statistical Areas (MSAs), Rural Service Areas (RSAs), Major Trading Areas (MTAs) and Basic Trading Areas (BTAs), and have very little regulation beyond federal licensing and radio propagation requirements, Communications Assistance for Law Enforcement Act (CALEA) requirements, and some limited federal and state consumer protection rules. Satellite carriers can have footprints that include much or all of the Continental United States or Alaska or Hawaii, and are subject to federal licensing and radio propagation requirements but little rate and service regulation. Cable operators have local franchise areas that may or may not be combined with other local franchise areas by a common headend, but presently have virtually no regulatory obligations other than some potential future CALEA requirements with respect to their telecommunications and information services. VoIP providers claim the worldwide Internet as their service area, and are subject to very limited federal Title I regulation other than some potential future CALEA obligations. Competitive local exchange carriers (CLECs) have substantial discretion to select and

design their own service areas, and are subject to minimal regulation beyond caps on their interstate access charges.

These differing service areas and regulatory regimes will produce a very uneven auction playing field. For example, a wireless carrier that serves the Denver and Colorado Springs metropolitan areas may bid for much less USF support to serve a mountain community west of the Front Range where an extension of its service area overlaps the study area of a rural ILEC, than can the rural ILEC whose study area consists solely of the community and some of the sparsely populated highlands and forests surrounding it. Moreover, ILECs will generally have substantially greater costs to recover than other potential bidders because they are subject to much more extensive and expensive service, quality and rate regulation, including Carrier of Last Resort obligations that have long required them to serve isolated and expensive customers and communities that would have remained unserved if the ILECs were free to make purely economic decisions.

How will the Commission design reverse auctions to prevent large national and regional carriers from riding roughshod over small local carriers situated on the periphery of their predominately urban service areas? How will the Commission evaluate the bids of carriers that have significantly higher costs because they are forced to comply with more onerous and expensive regulatory requirements? If a carrier loses an auction and its USF support, will it still be subject to the same pre-auction service and regulatory obligations?

The presence of existing investment (often substantial) in facilities and of existing customers further complicates reverse USF auctions. Unlike spectrum auctions and Latin

American subsidy auctions where the primary matter at risk is a future business opportunity, the loss of a USF auction and the prospect of no USF revenue stream for ten or so years can lead to severe and immediate economic distress, including service and staff cutbacks, breaches of loan covenants, stranded investment and even bankruptcy. Bidders facing the potential loss of substantial existing USF revenue streams may bid amounts that are a mere fraction of the levels that are sufficient for their existing operations in the hope that getting half a loaf rather than none will stave off bankruptcy at least for a while. While such defensive underbidding will absolutely preclude future infrastructure investment, it is also likely to require contemporary offsetting measures such as service and service quality cutbacks, employee layoffs and/or rate increases. How will the Commission evaluate the cost to a rural community if an existing local carrier winning or losing an auction is forced to cut back on its operations, services, expenditures, employees and/or investments?

And if a bidder loses a reverse USF auction and all of its existing USF support, it is unclear what will happen to its existing customers. Will they be forced to pay higher rates for the same services, to accept reduced service and service quality, or switch to a different service provider?

These complexities create a climate rife for gamesmanship. The history of federal and state anti-slamming measures shows that some entities will bend or break rules for even relatively small monetary gains or competitive advantages. In reverse USF auctions where the dollars at stake over ten or so years may be large and the penalties of losing substantial, certain auction participants will be tempted to submit lowball bids and/or misleading service proposals. How will federal or state regulators be able to detect

and/or prove gaming before declaring the winner of a reverse auction? What regulatory authority will be given the responsibility and resources to monitor and enforce compliance with the bidding and auction requirements before, during and after auctions? If cheating is discovered and proved years after an auction, how will it be possible to put Humpty Dumpty back together again and find a reliable carrier to invest in and serve the area?

It appears that some of the reverse auction procedures under consideration are: (1) to establish very detailed common USF service, quality and pricing standards to make the auctioned "item" more uniform; (2) to negotiate and enter into a detailed contract with each auction winner to ensure that it provides all of the service, quality, pricing and investment that it proposed in connection with its winning USF bid; and/or (3) to employ qualitative factors in addition to bid prices in selecting auction winners. All of these approaches have potential benefits, but would have to be designed and implemented very carefully to avoid unintended and adverse consequences.

As noted above, the development, implementation and enforcement of detailed and common service, quality and pricing standards for very different existing service providers would be very complex. At a very minimum, every auction winner and USF recipient should have Carrier of Last Resort obligations extending throughout the entire service area. However, even though they are needed for comparative purposes, it may be extremely difficult and disruptive to impose common service, quality, and pricing standards upon the very different existing service packages and pricing plans offered by ILECs, wireless carriers, satellite carriers, cable modem services, VoIP providers and CLECs.