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

Federal Communications Commission  
Office of the Secretary

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

NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION  
INITIAL COMMENTS

NATIONAL TELECOMMUNICATIONS  
COOPERATIVE ASSOCIATION

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INITIAL COMMENTS**

The National Telecommunications Cooperative Association (NTCA)<sup>1</sup> hereby submits these comments in response to the Federal Communications Commission's (Commission's or FCC's) Public Notice in the above referenced proceeding (Notice).<sup>2</sup> In this Notice, the Federal-State Joint Board on Universal Service (Joint Board) seeks comment on the use of reverse auctions (competitive low bidding) to determine high-cost universal service support funding to eligible telecommunications carriers (ETCs) pursuant to Section 254 of the Communications Act of 1934, as amended (the Act). NTCA supports the universal service goals of providing rural and urban consumers comparable rates and services, and curtailing excessive growth of and inefficiency in the high cost universal service fund (USF). However, the implementation of reverse auctions for determining the distribution of universal service in those areas with pre-

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<sup>1</sup> NTCA is the premier industry association representing rural telecommunications providers. Established in 1954 by eight rural telephone companies, today NTCA represents more than 572 rural rate-of-return regulated telecommunications providers. All of NTCA's members are full service incumbent local exchange carriers (ILECs) and many of its members provide wireless, cable, Internet, satellite and long distance services to their communities. Each member is a "rural telephone company" as defined in the Communications Act of 1934, as amended (Act). NTCA's members are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their rural communities.

<sup>2</sup> *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, Public Notice, WC Docket No. 05-337, CC Docket No. 96-45 (rel. August 11, 2006) ("Notice").

existing infrastructure and ubiquitous service would be a serious mistake. The potential downside of reverse auctions for the determination of universal service provision is too great, the risk of an unfavorable outcome too large, and the stakes too high for reverse auctions to be considered a feasible alternative.<sup>3</sup>

The difficulties and dangers inherent in applying reverse auctions in areas with existing communications infrastructure and ubiquitous service are carefully summarized in Professor Dale E. Lehman's paper "The Use of Reverse Auctions for Provision of Universal Service."<sup>4</sup> As Dr. Lehman identifies, while the track record of reverse auctions utilized in new service areas is of limited relevance to the U.S., theoretical evidence of reverse auctions in areas with existing infrastructure has not been studied, and scant empirical evidence of their usefulness exists.<sup>5</sup> Introducing such an unproven mechanism into such a vitally important process for determining and distributing high-cost USF support to ETCs would be extremely risky. Currently "[i]n the U.S there are few unserved areas: instead, there are multiple networks, using different technologies and with different quality attributes and serving different parts of rural areas."<sup>6</sup> Correctly designing and implementing an effective reverse auction mechanism for areas with existing infrastructure and ubiquitous service will therefore prove tremendously challenging, if not impossible.

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<sup>3</sup> 47 U.S.C. §254(b) ("reasonably comparable to those services provided in urban areas...at rates that are reasonably comparable to rates charged for similar services in urban areas").

<sup>4</sup> Dale E. Lehman is Director of the Executive MBA in Information and Communication Technology at Alaska Pacific University. He has taught at a dozen universities, and held positions of Senior Economist at Southwestern Bell Telephone Company and Member of Technical Staff at Bellcore. He has a B.A. in Economics from SUNY at Stony Brook, and M.A. and Ph.D. degrees in Economics from the University of Rochester. He has published widely in the area of telecommunications economics and policy, including a number of previous papers on behalf of NTCA.

<sup>5</sup> Lehman, Dale E. "The Use of Reverse Auctions for Provision of Universal Service," September, 2006, p. 10. Attached as an Attachment A to these comments.

<sup>6</sup> *Id.*, p. 3.

Moreover, the introduction of reverse auctions in existing service areas would impose additional risk for new entrants and incumbents alike. For new entrants, “endogenous market structure increases uncertainty for bidders, thereby requiring an extra risk premium in their bids.”<sup>7</sup> This risk premium impacts the competitiveness of certain auction participants and impacts the theoretical efficiencies to be gained from the auction process. For incumbents, the risk introduced by the auction process can be dramatic. Uncertainty about the future will make both service providers and lenders more wary about investment decisions.<sup>8</sup> Incumbents will have to make critical investment decisions in light of the very real possibility that they may be compelled to transfer capital to future auction winners.<sup>9</sup> Absent the assurance of the ability to fully recoup prudently incurred investments, “[i]t is unlikely many investments will take place with payoff periods longer than the duration of the franchise.”<sup>10</sup> Such an outcome would be contrary to the goals of universal service contained in Section 254 of Act of providing sufficient, predictable and sustainable universal service support.

NTCA therefore urges the Joint Board to reject the reverse auction concept and to consider and recommend the following alternatives to accomplish the same goals, with much less risk to those both providers who rely on sufficient, reliable universal service support for the provision of affordable communications services and to the consumers who rely on those providers:

1. Apply a meaningful public interest test when considering future ETC designations;
2. Eliminate the identical support rule;
3. Provide alternative cost based support to rural wireless ETCs; and
4. Expand the base of USF contributors to include all broadband service providers.

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<sup>7</sup> *Id.*, p. 10.

<sup>8</sup> *Id.*, pp. 23-24.

<sup>9</sup> *Id.*, p. 11.

<sup>10</sup> *Id.*, p. 12.

Implementing these four changes to the existing universal service rules will enable the Commission to ensure comparable rates and services for rural and urban consumers and rein in the excessive growth of and inefficiency in the high cost universal service fund associated with the identical support rule.<sup>11</sup> The proposed changes will also ensure that multiple ETCs in any given high-cost area in fact are necessary for providing rural consumers with affordable and comparable services. Lastly, expanding the base of contributors to include all broadband service providers will ensure sufficient, predictable and sustainable universal service support that will evolve with the future public communications network that will inevitably rely on IP-based transmission services.

**I. WHILE REVERSE AUCTIONS MAY BE AN APPEALING THEORETICAL CONSTRUCT, IN REALITY THEY ARE FRAUGHT WITH UNCERTAINTY AND RISK.**

The Joint Board seeks comment on the “overarching concept of using auctions to determine universal service support as well as the details associated with the accompanying obligations.”<sup>12</sup> In theory, the concept of utilizing a reverse auction to determine optimal disbursement is appealing. Auctions, in general, and reverse auctions in particular, offer the promise of allowing the marketplace to determine the value of the item up for auction and award the item to the party or parties who most highly value them. Further, auctions facilitate incorporating information that would otherwise be unknowable into the ultimate bid price. The critical question which must be answered, however, is can reverse auctions for universal service fulfill this promise in the real world? NTCA has therefore asked Dr. Dale Lehman to research the history of reverse auctions used to determine universal service disbursement, both

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<sup>11</sup> 47 C.F.R. § 54.307.

<sup>12</sup> Notice, p. 3.

domestically and overseas.<sup>13</sup> After thoroughly reviewing the issue, Dr. Lehman ultimately concludes that “[m]uch of the theoretical appeal of reverse auctions is dissipated under the actual conditions under which universal service will be provided.”<sup>14</sup>

- A. All of the parameters of a reverse auction for universal service would need to be precisely defined in advance of the auction – a daunting, if not impossible, challenge.**

The Joint Board asks “whether there are general lessons that can be learned from academic literature or elsewhere about the overall appropriateness of auctions for determining universal service support.”<sup>15</sup> As Dr. Lehman has found, reverse auctions tend to work best in those instances where a single project or set of projects is being offered (otherwise known as “competitive bidding”). In bidding for universal service funding, however, certain volatile factors—such as the significant investment costs required, or the rapid pace of technological deployment—make the use of reverse auctions problematic.<sup>16</sup>

The need to compare bids and select an ultimate winner will necessitate that reverse auctions be held for the exact same geographic areas. A hypothetical example clearly illustrates the dilemma. Suppose carrier A bids to serve customers 1 and 2 and carrier B only bids to serve customer 2. The bids can be compared for customer 2, but this leaves one carrier bidding to serve customer 1. If support is properly and fully calculated for providing service to customer 1, there will not be a problem. However, it is important to note that the per line support for customer 1 will need to be higher than it is currently when both 1 and 2 are served. More generally, the use of different geographic areas means that the carriers are bidding for different things – only the overlapping customers can be compared. Support must be calculated carefully

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<sup>13</sup> Attachment A.

<sup>14</sup> *Id.*, p. 22.

<sup>15</sup> Notice, p. 3.

<sup>16</sup> *See* Attachment, pp. 3-4.

for the remaining customers. Absent an explicit “apples to apples” type of comparison, it is nearly impossible to ensure an efficient outcome.

Auctions focus most heavily on one aspect of providing universal service (i.e., cost); they tend to downplay such non-quantifiable factors as quality of service (which can only be measured *ex post*), changing customer preferences, etc. Auctions tend to work well in those cases where the bid being made is readily quantifiable, where the service put out for auction is easily defined, the parameters of the service are relatively static, and progress and ultimate results can be easily measured. A reverse auction for universal service funding, however, will require that non-quantifiable factors be taken into account, as well. And not only will these non-quantifiable factors apply to the current state of the market, they will need to apply to the future of the marketplace.

The numerous variables associated with the provision of universal telecommunications service—different geographic areas served, different technologies utilized, the requirement to meet such difficult to measure goals as “reasonably comparable,” etc.—render the use of reverse auctions to determine the distribution of universal service support highly problematic, at best.

All specific features of the auction—definition of the service to be auctioned, size of areas to be defined, the number of carriers of last resort (COLR) to be subsidized, the time period for contract awards, transition and stranded investment issue, bidder eligibility, type of bidding to be conducted, basis for determining winning bids, pricing and service flexibility accompanying awards, and monitoring and enforcement issues--will need to be defined by the administrator.<sup>17</sup> Doing so—and doing so correctly—will necessitate a substantial, if not unrealistic, amount of information and insight on the part of the administrator.

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<sup>17</sup> *Id.*

**B. Reverse auctions create incentives that may be contrary to the provisions in Section 254 of the Act.**

The Joint Board seeks comment on whether and how a competitive bidding proposal would serve to preserve and advance universal service and remain consistent with these important statutory goals, including rate comparability and affordability.<sup>18</sup> Universal service auctions may create incentives for underbidding. Winning the auction requires bidding as low as realistically possible. The problem arises when participants are overzealous (or unscrupulous) and bid below a level which will allow them to provide services as required. The net result will be, at best, a deterioration in the quality of service provided; at worst, an inability to provide service altogether.

In its spectrum auction process, the FCC has already seen the difficulties caused by a winning party who was unable to meet its obligations. By comparison, spectrum auctions are relatively simple--the product at auction is discreet and readily defined. Only the spectrum itself needs to be defined, not how it will be used. An auction for universal service support, on the other hand, would require specific definition of the services to be provided, service quality, number of customers to be served, price, etc. Should a similar situation involving a non-performing bidder occur in a reverse auction for universal service, the consequences would be more serious.

Least-cost funding provides incentives for slashing service quality levels below acceptable levels. One way to minimize bids is to pare service quality levels to absolute

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<sup>18</sup> Notice, p. 3.

minimums. As a result, rural consumers might find that the types of service available to them become more limited, or that their quality of service deteriorates. This is not in the spirit of universal service, however, which mandates that services provided to rural consumers be “reasonably comparable to those services provided in urban areas.”<sup>19</sup>

Auctions are vulnerable to collusion and cheating. Often, auction participants have greater knowledge of the industry than does the regulatory body overseeing the auction. If two or more participants decide that the gains from working together to insure winning the auction outweigh the risks of losing the auction outright, they will have incentive to cheat. The ultimate losers are those auction participants who played by the rules, as well as the customers who will be receiving service from providers who would not have otherwise been awarded the franchise, but for their disregard for the auction rules.

The use of reverse auctions poses particular difficulties in instances where there is pre-existing infrastructure. The nature of the auction process discourages long-term investment in facilities. Uncertainty regarding the ongoing future availability of universal service support raises the overall risk factor inherent to investment in new facilities. Should an auction mechanism be implemented, the reality that any investment undertaken today may be stranded tomorrow will inevitably impact the decision-making processes of service providers. The end result may be that decisions are made that are not necessarily in the best interests of serving customers, but rather in an effort to minimize the provider’s exposure to the newly-introduced risk.

Winners who must participate in subsequent auctions will need to divert resources away from the provision of service. While the costs noted above are an obstacle for first-time auction

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<sup>19</sup> 47 U.S.C. §254(b).

participants, for incumbent providers, they will almost inevitably detract from the overall level of service being provided to consumers. Any time or money devoted to the auction process are resources that are not devoted to serving customers.

**C. A successful reverse auction requires an unrealistic knowledge of the future on the part of auction participants.**

Bidders are required to look into the future and assess the costs of providing service, incorporating such parameters as customer preferences and changing technology. Regulators will need to be prescient as well, particularly regarding such crucially important matters as the future definition of universal service. This is particularly problematic in an industry with a rapid rate of technological innovation, such as telecommunications. As the length of the contract period grows, so too does the overall level of uncertainty. On the other hand, as the contract period is shortened, the administrative costs associated with running and participating in an auction grow, as does the overall risk to the auction winners (i.e., making necessary investments only to lose a future auction).

Competing in auctions for more than one geographic region requires specific knowledge of the varying forward-looking costs in each of those regions. Effectively competing in auctions in different geographic areas will require detailed knowledge of the unique aspects of that area: i.e., market demand for services, geographic impediments to providing service, etc. This information will need to be collected on a going forward, as well as a current, basis. Misinformation or incorrect analysis could have a dire impact on the service provider.

**II. ADMINISTRATION OF A REVERSE AUCTION WOULD BE TIME AND LABOR INTENSIVE, PROHIBITIVELY EXPENSIVE, AND TECHNICALLY BURDENSOME.**

Auctions are expensive to conduct, time consuming, administratively difficult, and require some degree of training for participants. The potential for fraud, whether on the part of an

individual participant or through the collusion of several parties, is always present. Constant monitoring and vigilance would therefore be required to ensure the integrity of the auction results. The cost of administering the reverse auctions, preventing fraud, and monitoring the results would ultimately increase the size of the universal service fund and could outweigh any potential benefits gained from the process. As evidenced by the FCC's numerous spectrum auctions, participants are required to invest significant financial and human resource capital into the auction process. These costs are real and, often, substantial.

**A. It is extremely difficult to ensure that an auction is fairly run.**

The Joint Board seeks comment on "what constitutes an auction failure."<sup>20</sup> While auctions pose the potential for efficiency gains, they also provide both the incentive and the opportunity for cheating. As noted previously, collusion must be avoided. Forms, procedures and penalties must be developed to ensure that rules are followed. In addition, rules that allow fair representation by small companies must be defined and enforced. Unless the auction is correctly designed, large providers may have an advantage at auction over small providers, as they may have the ability to bid low for support and spread that loss over their entire customer base. Smaller carriers typically cannot sustain such a loss. Auction rules would need to be enacted that provide smaller carriers a meaningful opportunity to compete with larger carriers. While biasing auction results toward larger carriers might seem to imply that universal service is in all cases best supplied by larger providers, in reality this is simply not the case.

The administrator must have rules and procedures in place to respond to problems that arise during the auction itself. Detailed rules will have to be in place to allow for a smooth transition between the winner of the last auction and the winner of the next auction. All of these

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<sup>20</sup> Notice, p. 4.

considerations of transition to an auction system will have to be reworked for each auction. New rules must be developed to ensure that the state-designated ETC process is in compliance with the Act and is changed to meet the new auction standards. As NTCA has previously noted

the use of auctions to decide which carriers obtain support and how much they obtain would deprive the states of regulatory oversight of the ETC designation process and impinge on the ability of federal and state regulators to assess whether support is "sufficient" to achieve the goals of universal service. Even if ETC designations were left to the states, the use of competitive bidding to award support would render a state's determination *pro forma*.<sup>21</sup>

Support, services and other types of obligations (including intercarrier compensation) based on current definitions of ETCs, ILECs, CLECs and COLRs therefore would be redefined and all related rules will have to be restructured.

**B. An education process would need to be established to ensure that participants understood auction procedures.**

The Joint Board seeks comment "on the optimal structure for conducting an auction of this type."<sup>22</sup> Procedures must be developed to educate the bidders, owners, general managers and staff about how the auction will be conducted. Procedures and deadlines for registering to participate will have to be developed. Training workshops and mock auctions will need to be implemented to insure that participants are ready when the actual auction takes place.

Participants will need to be informed of deadlines they need to meet, forms they will need to submit, and software they will need to download, install, and become familiar with. Such planning not only imparts a cost upon the auction administrator, but also upon participants. Particularly for non-winning auction participants, resources expended in participating can be

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<sup>21</sup> NTCA Initial Comments, *In the Matter of Federal-State Board on Universal Service Seeks Comment on the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, FCC 03J-1, May 3, 2003, p. 17.

<sup>22</sup> Notice, p. 4.

considered sunk costs. The question, then, is should these carriers be entitled to compensation for time and resources spent to participate in the auction? Many companies who are already struggling to survive and provide services do not have the time or resources to dedicate to reeducation for a new system which might not, ultimately, result in support. In the extreme, these concerns may lead to a “no bidders” situation. Dr. Lehman cited examples of just such an outcome occurring in Australia and Maine.<sup>23</sup> This would be the worst case scenario—after all of the effort and expense was sunk into designing and running an auction, none of the potentially beneficial results would be realized. Given the draft proposal’s provision allowing the regulator to declare any auction “non-competitive” (and requiring such a declaration if there is only one bidder), there is a real possibility that all of this effort may not ultimately result in a successful competitive auction.<sup>24</sup>

**C. Ongoing evaluation would be required to ensure that participants were complying with auction rules, and enforcement policies would be needed to deal with those who were not.**

Procedures, rules and dedicated funding must be developed in order to ensure that the winning carrier complies with the service obligations. To this end, a quality of service baseline will need to be established. It is highly likely that these obligations will not be able to be standardized, but must vary according to different regions or different types of providers.

There may be a need for a trusted third party to perform evaluations of the success or failure of the auction and the service provided by the new carrier. Funding will be necessary to perform meaningful evaluations of a statistically significant sample of the service territories represented by a cross-section of types of providers and geographic areas. Without proper evaluation, the overall success of the auction will be unknown.

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<sup>23</sup> Attachment A, pp. 16-17.

<sup>24</sup> Notice, pp. 8-9.

Monitoring of service obligations also must be conducted with clearly defined consequences. Penalties will need to be imposed upon those who fail to meet the pre-defined standards. If a carrier should default in its service obligations under the new auction rules, who will be required to provide service, and how will they be compensated? Who will ensure that emergency operations are available? In addition, enforcement is a critical component of the auction process. Without enforcement and compliance with service standards, the consumer and the national network are both at great risk. Without evaluation, connectivity with the nation's most vulnerable and isolated populations could be lost, perhaps unknowingly.

**D. Steps will be necessary to try to mitigate the very substantial risks.**

The Joint Board seeks comment on how auctions for high-cost support “could be designed to appropriately target support to areas in need of support.”<sup>25</sup> The auction designer and program administrator will need procedures and staff in place to determine if an area is being unserved or has been abandoned due to insufficient support as a result of unrealistic bids. Similarly, there will need to be procedures in place to address the situation where actual costs exceed the winning bidder's estimates and the company goes bankrupt or can't survive. The greatest danger under such a scenario is that end use customers could end up with poor, little, or no service. Consumers in high-cost, remote, underserved, low-income and disadvantaged areas—the same consumers who are the intended beneficiaries of the universal service program in the first place—are at the greatest risk. Plans must be established ahead of time to deal with such a situation swiftly and effectively.

**E. Reverse auctions raise stranded investment and confiscation issues.**

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<sup>25</sup> *Id.*, p. 4.

Rate-of-return rural ILECs are making good on their promise to deliver broadband services to rural areas.<sup>26</sup> Rural ILECs have made significant investments in the rural high-cost portions of America under an existing universal service support system that allows for recovery of a sufficient portion of a carrier's embedded costs of total regulated facilities. If these costs are no longer recovered through universal service, and an alternative recovery method is not available or prohibited by regulators, then these costs will become stranded investment.<sup>27</sup> As Commissioner Copps stated:

[i]t is essential, that any regime we adopt increase certainty so that rural carriers can plan for the future and undertake necessary investment to modernize the telecommunications infrastructure in their communities.<sup>28</sup>

Given the Act's goal of preserving and advancing universal service to ultimately provide consumers with access to advanced telecommunications and information services, failure to address stranded cost would be completely at odds with the intent of Sections 254 and 706 of the Act.

If a rate-of-return ILEC loses a bid, the new provider will take over the service territory and some of the rural ILEC's network may be stranded or underused. Similarly, if a rate-of-return carrier wins the bid and its going forward support is fixed for x-number of years, its ability to recover its regulated cost will be at risk and stranded investment may result. Given that a portion of a rate-of-return ILEC's investments/costs are recovered through universal service support and were approved as reasonable by state and federal regulators, ILECs should receive

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<sup>26</sup> *NTCA 2006 Broadband/Internet Availability Survey Report*, August 2006, [www.ntca.org](http://www.ntca.org).

<sup>27</sup> The term "stranded investment" typically means plant facilities that are no longer in use and have not fully recovered their costs. However, in the context of this proceeding, stranded investment can result in plant facilities that are not fully recovering their costs but are still in use.

<sup>28</sup> *In the Matter of the Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77; *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, (2001)(MAG Order), *Dissenting Statement of Commissioner Michael J. Copps*.

cost recovery for these investments. In addition, regulators will need to decide in advance if the new provider will be allowed to use the portions of the rural ILEC's network, and at what level of compensation to the ILEC. Regulators will therefore need to adopt procedures and rules to compensate investors for the physical structures that may now go unused or be repurposed. Prudently-incurred investments made under the prevailing business and regulatory climate at the time they were made deserve reasonable compensation. (The Draft Proposal in the Notice calls for incumbents to make available its assets at "fair market value," a problematic and ill-defined term: e.g., is it the fair value at the time they become stranded, or at the time the investment was first made?).<sup>29</sup> It will fall to the regulator to solve the difficult matter of determining the specifics of the compensation.<sup>30</sup> These administrative and legal concerns are significant and complex.

The Supreme Court recognized the important role states play to avoid issues of preemption and confiscation.<sup>31</sup> The Court stated that, "proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction." Congress obviously intended that state and federal representatives work together, make compromises and negotiate something that would work for both the federal government and the states. Given the complexities of the issues in this proceeding and the potential far-reaching ramifications, it is difficult to imagine that a reverse auction proposal can adequately address stranded investment issues associated with rate-of-return regulated rural ILECs unless the recovery of past investments is provided for before the auction is put into place.

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<sup>29</sup> Public Notice, p. 8.

<sup>30</sup> It is interesting to note that the electric utility industry has been struggling with this stranded investment problem for many years without ultimate resolution. See, "Electric Utilities: Deregulation and Stranded Costs," Congressional Budget Office, October 1998.

<sup>31</sup> *Smith v. Illinois*, 282 U.S. 133, 51 S. Ct. 65 (1930).

**III. NTCA's PROPOSED ALTERNATIVES WOULD ADDRESS THE ACT'S UNIVERSAL SERVICE GOALS WITH MORE CERTAINTY AND MUCH LESS RISK TO RURAL CONSUMERS.**

The current policies for determining and distributing rural high-cost USF support have enabled the Commission to reach and maintain a 93 percent universal service penetration rate in U.S. households.<sup>32</sup> Adopting a new reverse auction mechanism could jeopardize this achievement by the United States and create significant disincentives for rural carriers to continue to invest and to provide high-quality affordable basic and advance services to their rural communities.<sup>33</sup> Rather than heading down the very uncertain and risky path of attempting to implement reverse auctions in areas with preexisting infrastructure and ubiquitous service, the Joint Board should consider more certain and less risky alternatives for providing affordable and comparable services, efficiently managing the growth of high-cost USF support, and sustaining universal service in rural, high-cost areas throughout the United States. Consumers in most high-cost service areas are already receiving affordable and comparable voice communications services through either the ILEC and/or wireless CETC. Thus, the Act's goal of providing comparable rates and services has been achieved. The need to add additional CETCs in rural high-cost service areas therefore should be limited on a going forward basis.

The statutory universal service goals contained in Section 254 do not promote USF competition nor direct the Joint Board or the Commission to use universal service support dollars to artificially stimulate competition. The focus of the Joint Board in this proceeding therefore should focus on the goals of Section 254 and consider alternative proposals that will maintain the existing affordability and quality service consumers receive in rural, high-cost areas. As

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<sup>32</sup> FCC Report: *Telephone Subscribership in the United States, Data Through November 2005* (rel. May 2006), [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-265356A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-265356A1.pdf)

<sup>33</sup> 47 U.S.C. 254(b)(5) states that Federal and State mechanisms to preserve and advance universal service should be specific, predictable and sufficient.

discussed previously, reverse auctions will likely lead to the deterioration of service quality, customer confusion and dissatisfaction, and, at worst, the inability to provide service to consumers living in rural, high-cost areas. NTCA therefore urges the Joint Board to consider and recommend the proposed alternatives described below to accomplish the same goals, with much less risk to those consumers who rely on sufficient, reliable universal service support for the provision of affordable communications services.

**A. A Meaningful Public Interest Test Should Be Applied When Considering Future ETC Designations**

NTCA agrees with Chairman Martin when he stated that in “my view, the main goals of the universal service program are to ensure that all consumers--including those in high cost areas--have access at affordable rates. I remain hesitant to subsidize multiple competitors to serve areas in which costs are prohibitively expensive for even one carrier.”<sup>34</sup> The Act seeks to provide consumers in rural and high cost areas have services and rates comparable to urban areas.<sup>35</sup> The Act does not guarantee that rural and high cost areas have the same number of supported ETCs as urban areas. Therefore, rather than simply granting additional ETC designations through reverse auctions or otherwise, the states and the Commission must look at whether support will in fact promote comparability between rural and urban areas. As Commission Adelstein stated, “[those performing the public interest analysis] also need to consider whether the new service proposed is an enhancement or an upgrade to already existing or currently available service.”<sup>36</sup> The Act provides that there be specific, predictable, and

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<sup>34</sup> *In the Matter of the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 04J-1, Joint Board Recommended Decision, Separate Statement of FCC Commissioner Kevin Martin (rel. February 27, 2004)

<sup>35</sup> 47 U.S.C. § 254(b)(3).

<sup>36</sup> Speech by Commissioner Jonathan Adelstein, “Rural America and the Promise of Tomorrow,” NTCA Annual Meeting & Expo, Phoenix, Arizona (February 3, 2003).

sufficient Federal and State mechanisms to preserve and advance universal service.<sup>37</sup> It is therefore incorrect for regulators to ignore the demand for and ultimate sustainability of the universal service mechanisms as they decide future ETC designations.<sup>38</sup>

In the past, the states and the Commission have performed no more than a perfunctory CETC public interest analysis. They have found that CETC designation in rural areas fulfills federal policies favoring competition. The states and the Commission, however, have not sufficiently considered that subsidized competition and competition for competition's sake are not the universal service goals in the Act and may ultimately harm the consumer. The public interest determination in Section 214(e)(2) and (6), however, is not synonymous with the mere introduction of competition because Congress required more than the mere certification of all applicants seeking ETC designation.

Commissioner Adelstein previously stated the need to balance competition against the public good, stating, "The public interest . . . demands that regulators seriously consider whether a market can support more than one carrier with universal service. If not, then new designations shouldn't be given as a matter of course just because it appears they meet other qualifications."<sup>39</sup> Commissioner Adelstein's remarks echo earlier statements of Chairman Martin. In a separate statement to the Order adopting the MAG plan, the Chairman Martin questioned "the Commission's policy . . . of using universal service support as a means of creating 'competition' in high cost areas."<sup>40</sup> Chairman Martin also recognized that subsidizing multiple competitors in

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<sup>37</sup> 47 U.S.C. § 254(b)(5).

<sup>38</sup> *In the Matter of RCC Holdings, Inc., Petition for Designation as an Eligible Telecommunications Carrier Throughout its Licensed Service Area in the State of Alabama*, CC Docket No. 96-45, DA 02-3181, Memorandum Opinion and Order (rel. Nov. 27, 2002).

<sup>39</sup> Speech by Commissioner Jonathan Adelstein entitled "Rural America and the Promise of Tomorrow," NTCA Annual Meeting & Expo, Phoenix, Arizona (February 3, 2003).

<sup>40</sup> Separate Statement of Commissioner Kevin J. Martin in *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers Federal-*

an area that cannot support it “may make it difficult for any one carrier to achieve the economies of scale necessary to serve all of the customers in a rural area, leading to inefficient and/or stranded investment and a ballooning universal service fund.”<sup>41</sup> This is an issue that should be considered as part of the public interest test when determining whether an additional ETC is in the public interest.

The public interest test should not focus on whether support will enhance competition but whether universal service is being maintained and preserved in accordance with the principles of Section 254. The public interest test should look at whether rural customers are receiving comparable services and rates as a result without designating additional ETCs within a designated area. Will designating additional ETCs result in sustained comparability of rates and services in rural areas or will they lead to a deterioration of services and disparate rates? Will current multiple ETCs promote investment in the facilities needed to afford rural customers access to comparable broadband services at comparable rates? As Dr. Lehman correctly identifies:

Artificially induced competition in rural areas serves to undermine the already weak business case for broadband deployment. It threatens the revenue base for [rural carriers] but does not reduce the investments required to provide service [and continue to meet carrier of last resort obligations]. ... Universal service should not be used to induce competition. Entry will occur where market conditions permit it.<sup>42</sup>

A meaningful public interest test should therefore look beyond the short-term and consider the long-term impact of multiple ETCs within a single designated area on evolving services that are likely to be deployed widely in urban areas, namely broadband services. It cannot be assumed

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*State Joint Board on Universal Service Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, 16 FCC Rcd 19613 (2001).

<sup>41</sup> *Id.*

<sup>42</sup> Dale Lehman, *The Cost of Competition*, NTCA 21<sup>st</sup> Century White Paper Series, Paper 3, p. 3 (December 2000).

that evolving broadband services will emerge in high-cost rural areas merely as a result of introducing multiple ETCs.

**B. Eliminate The Identical Support Rule**

NTCA agrees with FCC Commissioner Jonathan Adelstein, Bob Rowe, and Nan Thompson in that they “believe that we have a sufficient record to recommend a policy goal that the amount of universal service support paid to competitive providers should not be based on the incumbent’s costs.”<sup>43</sup> The Act provides that all Americans should have access to adequate telecommunications services at reasonable and affordable charges.<sup>44</sup> It does not provide that every unregulated CETC should receive the identical amount of universal service support that the rural ILEC receives. The Joint Board should not assume or pretend that support to wireless CETCs is not excessive and that they are using the support for the purposes intended. By doing so, the Commission cannot ensure CETC compliance with the Act or the preservation of universal service. The Joint Board should therefore recommend the elimination of the “identical support rule” in its upcoming recommendation to the FCC.<sup>45</sup>

National and regional wireless carriers are not “rural telephone companies” as defined by the Telecommunications Act of 1996.<sup>46</sup> Because of the identical support rule, however, these

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<sup>43</sup> Commissioners Adelstein and Rowe recommend that carriers receive support based on their own costs. Commissioner Thompson would not yet rule out the options that in high cost competitive markets support be based on a forward looking methodology or a bidding process. See, *In the Matter of the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Joint Board Recommended Decision, Separate Statement of Commissioners Adelstein, Rowe, and Thompson (rel. February 27, 2004)

<sup>44</sup> 47 U.S.C. § 151.

<sup>45</sup> 7 C.F.R. § 54.307. The identical support rule allows CETCs to receive the same per-line support as rural ILECs based on the ILEC’s costs.

<sup>46</sup> Based on a Joint Board recommendation, in 1997 the Commission adopted, for universal service purposes, a definition of rural carrier that mirrored the definition of “rural telephone company” found in section 153(37) of the Act. See 47 U.S.C. § 153(37); *Universal Service First Report and Order*, 12 FCC Rcd at 8943-44, ¶ 310. Pursuant to this definition, a rural telephone company is a local exchange carrier operating entity to the extent that the entity:

(A) Provides common carrier service to any local exchange carrier study area that does not include either:

large wireless providers are able to circumvent this fact and receive substantial amounts of high-cost support tied to “rural telephone company” costs that have no relationship to their wireless costs.<sup>47</sup> Indeed, CETC support has escalated from \$106 million in 2003 to \$1.03 billion in 2006,<sup>48</sup> an 870 percent change over this three year period. During this same time, ILEC high-cost USF support has remained unchanged at \$3.17 billion.<sup>49</sup> The identical support rule is clearly the root of the escalating fund problem.

The identical support rule allows CETCs to receive the same per-line support as rural ILECs based on the ILEC’s costs.<sup>50</sup> Thus it is entirely possible for a large wireless CETC to receive rural support even if it can be extremely profitable in rural markets without support. Indeed, the District Court in Nemaha County, Kansas, overturned a decision by the Kansas Commission that would have made state universal service support received by rural ILECs portable to CETCs on a per-line basis. The court determined that providing support to a CETC based on the costs of an ILEC is not competitively neutral. The Court found that:

The Order of the [Kansas Corporation] Commission violates the [state’s] statutory requirement to make distributions in a “competitively neutral manner,” because the Commission has failed to evaluate all the necessary cost/expense information from all providers. The LEC’s [sic] are different in structure and treatment than

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- (i) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
  - (ii) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(B) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(C) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(D) Has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.

<sup>47</sup> National and regional wireless carriers are currently receiving per-line support based on the costs of many small, landline, incumbent rural telephone companies serving less than 50,000 customers including such states as Alabama, Iowa, Michigan, Mississippi, Montana, North Dakota, South Dakota, Texas, Virginia, West Virginia, Washington, and Wisconsin.

<sup>48</sup> See, Universal Service Administrative Company (USAC) filings with the FCC: USAC 1Q2003 HC01 and USAC 2Q2006 HC01.

<sup>49</sup> *Id.*

<sup>50</sup> 47 C.F.R. § 54.307.

the wireless providers. Attempting to establish competitive neutrality without evaluating all providers' costs and expenses, means that the [Kansas Corporation] Commission has compared apples to oranges. In order that its orders are competitively neutral, the [Kansas Corporation] Commission must compare the same units of measure.<sup>51</sup>

This regulatory disparity has created a dangerous incentive for wireless carriers to seek CETC status in rural high-cost areas where they already provide ancillary wireless service to ILEC customers. Even if the management of a wireless carrier knows that their costs are low enough to compete effectively without the additional support, they are compelled by the identical support rule to seek CETC designation so as to maximize profits and avoid lost opportunities to obtain support. This has led to a dramatic increase in CETC rural high-cost universal service support over the years. When a wireless CETC receives universal service support under these circumstances it is very likely a windfall.<sup>52</sup>

### C. Provide Alternative Cost Based Support To Rural Wireless ETCs.

To correct the problems associated with the Identical Support Rule the Joint Board should consider the following proposed changes:

- (1) Apply a similar size criteria in the statutory definition of a "rural telephone company" to determine whether a wireless CETC should be treated like a "rural telephone company" (e.g., a similar "rural wireless carrier" criteria would include a wireless provider with less than 100,000 connections within a state);
- (2) Allow all wireless CETCs that do meet this "rural wireless carrier" criteria the option of receiving per-line support based on a reasonable small rural wireless carrier proxy mechanism for that state or demonstrate

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<sup>51</sup> *Bluestream Telephone Company, et al vs. Kansas Corporation Commission*, In the District Court of Nemaha County, Kansas, Case Nos. 01-C-39, 01-C-40, 03-C-20, and 2004-CV-19, Memorandum and Decision (rel. April 30, 2004).

<sup>52</sup> Salomon Smith Barney, *Wireless Services, USF Subsidies May Significantly Improve Subscriber Economics for Rural Carriers*, Multi-Company Note, p. 1 (January 21, 2003) ("USF is the single-most important opportunity for rural wireless carriers to improve their return on capital.") *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d at 412 (U.S.C.A. 5<sup>th</sup> Cir. July 30, 1999) ("The term 'sufficient' appears in § 254(e), and the plain language of § 254(e) makes sufficiency of universal service support a direct statutory command rather than a statement of one of the seven principles.").

their wireless costs in order to determine whether the CETC is eligible to receive support and at what per-line support amount, based on the wireless CETC's own costs. (The Commission would determine a rural wireless carrier proxy model.)

- (3) Allow all wireless CETCs that do not meet the "rural wireless carrier" criteria the option of receiving per-line support based on the non-rural high-cost proxy mechanism for that state or demonstrate their wireless costs in order to determine whether the CETC is eligible to receive universal service support and at what per-line support amount based on the wireless CETC's own costs.

Both rural wireless carriers with less than 100,000 connections within a state and larger wireless carriers do not have the same costs or regulatory obligations as rural ILECs. Wireless carriers neither provide the same quality of local service or interstate access services to consumers. Wireless carriers do not have carrier of last resort obligations. They do not use the same type of facilities to provide services. Wireless CETCs do not have high-cost loops and do not provide ubiquitous local service. They also do not have the interstate access costs relevant to the interstate common line support (ICLS) mechanism because they have no wireline local loops on which the ICLS mechanism is based. And, unlike rural ILECs, wireless CETCs do not offer equal access to all long distance carriers and hence wireless CETC costs for providing access to a single long distance carrier are likely to be very different than the rural ILEC's costs. Thus, "rural wireless carriers" designated as CETCs in a rural ILEC study area, should not receive the identical per-line support as the ILEC, based on the ILEC's costs.

This proposed rule change would enable the FCC to more effectively manage the future growth of the high-cost fund while at the same time provide affordable and comparable rates and services to consumers. With the elimination of the identical support rule and allowing all wireless CETCs the option to base their universal service support on their own costs, the FCC