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

In the Matter of	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
Request for Comment on the Merits of Using Auctions To Determine High-Cost Universal Service Support	)	

REPLY COMMENTS OF THE
MONTANA PUBLIC SERVICE COMMISSION

1. Overview and Background

The Montana Public Service Commission (Montana PSC) respectfully submits these reply comments in response to the Federal-State Joint Board on Universal Service's (Joint Board) August 11, 2006, public notice FCC 06J-1, regarding high-cost federal universal service fund (FUSF) support. The Montana PSC thanks the Joint Board for having initiated this proceeding and for this opportunity to reply to comments on the complex set of interrelated FUSF issues that the Joint Board has raised. The Joint Board's public notice is a thoughtful exercise to stimulate discussion.

The Joint Board seeks comments on the use of reverse auctions (auctions, competitive bids, bids) to determine high cost universal service funding to eligible telecommunications carriers (ETCs) pursuant to Sec. 254 of the Communications Act of 1934, as amended (Act). The Joint Board inquires into both the merit of auctions and how auctions would be implemented (*e.g.*, identifying recipients, establishing the funding levels for recipients). The Joint Board also seeks general comments on how auctions could be used to further the goals of the Act.

The Joint Board has previously advised the Federal Communications Commission (FCC) on the use of bid mechanisms for purposes of universal service. Without an apparent referral from the FCC the Joint Board has decided to build a record to make a recommendation to the FCC on the subject of using auctions to ration FUSFs. The FCC has previously sought comments on whether there are other mechanisms, besides cost- or rate-based mechanisms, that address limiting the growth of the high-cost fund. The Montana PSC has provided the FCC with comments on how to limit the growth in the FUSF, primarily suggesting and supporting an end to the identical support mechanism (ISM). The Montana PSC has also previously commented on the inappropriateness of using auctions for purposes of FUSFs.[1]

The Montana PSC finds wise counsel in the initial comments of many parties to this Joint Board inquiry.

2. Merits of Reverse Auctions

The Montana PSC found informative and helpful the initial comments of the Independent Telephone and Telecommunications Alliance (ITTA). *ITTA, Comments, October 10, 2006*. ITTA's comments serve to remind us of the occasions on which the FCC and the Joint Board have previously raised issues that remain pending and that relate to the present Joint Board inquiry on auctions.

As evident from the ITTA comments and analysis, the growth in support that competitive ETCs (CETCs) receive is the critical driver of the overall growth in the high cost fund. ITTA asserts that this growth threatens to harm other successful universal service programs such as the Schools and

[1] Montana PSC's May 25, 2006, Reply Comments, Federal-State Joint Board, CC Docket No. 96-45, Universal Service High-Cost Universal Service Support, WC Docket No. 05-337.

Libraries, Low Income, and Rural Health Care. ITTA adds that the identical support rule (identical support mechanism, ISM) is neither technologically nor competitively neutral, but instead can be "profoundly anti-competitive." *Id., p. 24.*

The Montana PSC agrees with these ITTA concerns and strongly urges the Joint Board to recommend to the FCC that all designated ETCs file their own cost studies, instead of relying on the costs of incumbent local exchange carriers (ILECs), costs that may not even be based on the same technology.[2] In initial comments, the Northwestern Associations (NWA),[3] CenturyTel Inc., OPASTCO, and others have also recommended the elimination of the ISM. The Montana PSC agrees with these parties as well. As the Montana PSC has previously commented, the ISM is a major source of FUSF growth. In lieu of an uncertain auction process the elimination of the ISM can achieve the Joint Board's goal of rationally limiting the growth of the FUSF.

In its initial comments, the Montana Independent Telecommunications Systems (MITS) asserts that little has changed since it last filed comments on the pros and cons of reverse auctions as a method of distributing high-cost support. *MITS, Comments, October 10, 2006.* MITS also adds that auctions are noteworthy as they tend to reduce high-cost fund demand, although no universal service principle states that such funds need be as small as possible, and may slow or reverse the high-cost fund growth.[4] Thus, while auctions may rein in fund growth, regulatory safeguards must be in place to

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[2] See f.n. 1 (*i.e.*, Montana PSC filing with the FCC in opposition to the ISM).

[3] NWA members include the Montana Telecommunications Association, the Oregon Telecommunications Association Small Company Committee, and the Washington Independent Telephone Association.

[4] MITS adds that auctions are one of several means by which to achieve this goal. Other means include fund caps, a limit on the number of ETCs, and redefined eligibility requirements.

ensure that the goal of universal service is achieved, not just a reduction in funding.

The balance of the MITS comments address implementation problems associated with an auction. The Montana PSC finds particularly relevant the MITS distinction between the goal of achieving universal service and the objective of minimizing the size of the FUSF. As a matter of first principles, any unnecessary reduction in the size of the fund that hampers the achievement of universal service will not likely satisfy Sec. 254. As CenturyTel, Inc. (CenturyTel), comments, the statutory requirements of sufficiency and predictability are placed at risk by an "unproven" and "high-risk" auction mechanism. Again, the elimination of the ISM is the most obvious candidate that achieves both the goal of universal service and the stemming of growth in the FUSF.

In its initial comments Qwest Corporation (Qwest) emphasized that while competition is a key goal of the Act, it is not a guiding principle for universal service and universal service was not intended and should not be used to promote competition. The Montana PSC agrees with Qwest's comment. The PSC is not persuaded by initial comments that there is merit in auctions to ration FUSFs.[5] A better remedy is to eliminate the ISM.

3. Implementation of Reverse Auctions

The Montana PSC provides reply comments on a number of implementation issues raised in the initial comments of ITTA, MITS, NWA, and CenturyTel.

The ITTA illuminates a compound annual percentage growth rate of 6.3% in "per-line investment." *ITTA, Comments, p. 17, October 10, 2006*. This value is particularly noteworthy in light of the Joint Board's proposal permitting ILEC ETCs to elect to be treated as the winning broadband

[5] See f.n. 1 and 2.

network bidder for the first ten-year term. With the Joint Board's proposal, ILECs would be allowed an annual inflation adjustment. NWA commented, however, that by indexing (limiting) increases in the FUSF to inflation, network investment, including for broadband, may be discouraged due to higher than inflation-level cost increases. In its comments, CenturyTel also expressed concern about how an auction will impact the incentive of carriers to invest in rural areas. CenturyTel predicts that an auction mechanism will set off a "race to the bottom" and relegate rural communities to inferior service.

The Montana PSC finds these comments sufficient to raise serious doubts about the value of auctions to simply reduce FUSFs. Aside from questions about the legitimacy of auctions, auctions seem to be an obvious detriment to the provision of universal service.

NWA raises a number of issues. First, NWA raised several questions in regard to the Joint Board's discussion proposing that entities bid for contracts for ten-year terms, but that the incumbent wireline ETC could opt to be declared the winner for the first ten years. NWA questions how such a mechanism would assure predictable and sufficient support given that rural ILECs finance their systems, including broadband, with longer than ten-year loans from, for example, the Rural Utilities Service (RUS). Because of the potential need for more rapid depreciation rates and shorter term loans with higher interest rates, NWA expects that one possible outcome could be a significant increase in the FUSF. Thus, the effect that bidding may have on continued low-cost loan sources needs careful evaluation. The Joint Board's proposal to require an ETC to relinquish facilities at fair market value also raises questions about how a regulatory agency can mandate the sale and the ability of the regulator to, in effect, condemn property.

The PSC concurs with these concerns of NWA. There is a relationship between NWA comments about financing and the initial comments of the Rural Telephone Finance Cooperative (RTFC). In its initial comments RTFC

states that it provides more than $2 billion in loans to creditworthy systems eligible to borrow from the RUS. *RTFC Initial Comments, October 10, 2006*. RTFC holds that auctions will discourage investment, result in less quality of service for rural Americans, and pose dire consequences for the infrastructure investment by incumbent rural LECs (RLECs). RLECs already identify their costs, following FCC accounting practices, and they have an incentive to minimize costs. In the Montana PSC's estimation, there is no reason to subject incumbent RLECs to auctions which would cause a long-term deterioration of service for rural Americans.

The Joint Board's proposal could have the unintended consequence of increasing the FUSF. In addition, it escapes the Montana PSC as to how the Joint Board intends, on one hand, to employ an auction process and, on the other hand, to allow the incumbent ETC to elect to be treated as the winning (broadband) network bidder. This notion appears to be insufficiently described in the public notice to permit a robust initial and reply comments.

Second, NWA commented on the Joint Board's question of whether "more than just price" should be used to determine who wins a bid. The Joint Board was, in the opinion of NWA, unclear on how to evaluate quality of service (QOS) issues. NWA adds that whereas the states have implemented QOS standards for wireless ETCs, the Joint Board's discussion suggests that QOS standards would be contractual. In this regard NWA asked numerous questions: 1) would the contract for a state incorporate existing wireline QOS standards and would they apply to the auction winner; 2) would QOS standards be subject to negotiation; 3) could QOS vary within a state depending on who the bid winner is; 4) would there be a reduction in QOS; 5) if providers of WiFi or satellite technology can bid, what QOS standards would apply; and 6) will the use of a bid preempt state regulation of QOS? The NWA concludes that QOS concerns are one reason to determine the auction winner on a basis of more than just price. In addition, it is essential

that QOS standards be established in advance of an auction so that bidders know what they must provide.

MITS also raised significant concerns that are related to the above NWA concern with QOS. In the estimation of MITS, the disadvantages of auctions surround the meaning of the phrase "acceptable quality of service." One issue is whether acceptable QOS is limited to just providing the supported services or whether reliability, customer service, credit policies, truth-in-billing, and so forth are also valid QOS considerations. At present, state PSCs set acceptable QOS standards. There could occur, however, a case where the QOS standards for an ETC are less than that to maintain its certification of public convenience and necessity. Thus, there may emerge widely varying QOS standards. MITS concludes that the debate over QOS will be most difficult, especially for mobile service providers. MITS references the QOS standards imposed on designated ETCs by the Montana PSC. If for example, if three wireless carriers serve a rural service area, then will awarding one the "winner" status determine the survivability of the other two? MITS raised another issue involving the case where an incumbent that may only have 10% of the market could elect to be the broadband bidder, whereas a neighboring RLEC may have invested in and captured the majority of the customers in the same area.

The Montana PSC concurs with these QOS concerns that both NWA and MITS have raised. QOS standards must be established in advance of any auction as bidding should not focus on price alone.[6] In this regard, Alfred E. Kahn has asserted that price has no meaning except in terms of an assumed service quality, as price is a ratio of money to the physical unit of

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[6] The PSC would only note that there are other parties that expressed concern over the impact auctions will have on QOS (*e.g.*, the comments of CenturyTel , ITTA, and Qwest).

quality and quantity.[7] As Kahn has stated price and quality are inseparable. As both must be considered if auctions are to be non-discriminatory, the Joint Board should first establish the QOS standards for the services for which it intends to recommend auctions as a means to ration FUSFs. The Joint Board's QOS standards should not, however, preempt state PSCs from establishing their own QOS requirements.

Third, NWA raised concerns about the Joint Board's discussion proposal on how to target support to areas of need. NWA find the proposal to use a "county," as the basis has the disadvantage of resulting in both over- and under-stating the need for support. The need for FUSF support could be understated when a county contains two (or more) carriers that have varying densities, with one receiving and the other not receiving support based on their respective service areas. A shift to a "county" basis could result in, on average, no need for support for the high cost carrier. NWA notes that the converse could occur in another county depending on the kind of density or per capita income test that is used to qualify a county for high cost support.

The Montana PSC finds that the NWA observations are ones that the Joint Board must address before it advocates a new geographic basis for universal service funding. The PSC is also concerned about how the Joint Board's proposal may give rise to cream skimming.

In its comments, CenturyTel states that if the Joint Board is, after consideration of all the reasons given in objection to its auction proposal, inclined to recommend that the FCC pursue auctions, then the auction mechanism should only be used for two circumstances. The first circumstance is to attract one carrier to serve previously unclaimed high-cost areas. The second circumstance is to award one carrier support from among multiple CETCs using similar network platforms (*e.g.*, CMRS).

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[7] The Economics of Regulation: Principles and Institutions, p. 21, Alfred E. Kahn, MIT, Cambridge, MA (1970). See also, the PSC's May 25, 2006, comments filed with the FCC (CC Docket No. 96-45, WC Docket No. 05-337).

The PSC is not persuaded that the first circumstance that CenturyTel mentions is a good candidate for auctions. The Montana PSC simply has no information on when such circumstance might arise. Although the Montana PSC disagrees with using auctions to ration FUSFs, there are prerequisites in terms of minimal conditions that may not be met and that involve the number of competitors. An obvious problem is the case of when only one carrier serves, or bids to serve, an area. It is not so obvious that even when there are circumstances having more than one competitor that an auction may still fail.

As for CenturyTel's second circumstance, the PSC understands that there are ILEC study areas that are served by multiple wireless carriers. Qwest also expressed concern with using auctions in high-cost areas when there is only one current provider, adding that auctions may be inappropriate. Far from there being robust competition, the areas that the wireless carriers serve, or that they may serve, may not all overlap. Thus, as a practical matter, to have an auction to provide service in a geographic area runs up against the fact that not all carriers serve the same geographic areas. There also emerges the associated carrier of last resort obligations. Consequently, CenturyTel's proposal is not apparently a solution to the Montana PSC's objections to using auctions to ration FUSFs.

4. Conclusion

The Montana PSC again thanks the Joint Board for the opportunity to provide these reply comments to, in turn, shape the Joint Board's recommendations to the FCC. The PSC urges the Joint Board to not recommend the use of reverse auctions to ration FUSFs. Reverse auctions will jeopardize universal service generally and could be particularly harmful for customers in rural areas.

Dated this 8th day of November, 2006.

MONTANA PUBLIC SERVICE

COMMISSION

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