Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board	)	WC Docket No. 05-337
On Universal Service	)	

REPLY COMMENTS OF EMBARQ CORPORATION TO THE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE ON THE PUBLIC NOTICE REGARDING THE MERITS OF USING AUCTIONS TO DETERMINE HIGH-COST UNIVERSAL SERVICE SUPPORT

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November 8, 2006

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To: The Federal-State Joint Board on Universal Service

EMBARQ FEDERAL-STATE JOINT BOARD REPLY COMMENTS

Embarq Corporation (Embarq), on behalf of its local operating companies and interexchange and wireless operations, offers the following reply comments in response to the Federal-State Joint Board on Universal Service (Joint Board) Public Notice on the merits of using auctions to determine high-cost universal service support.[1]

It is not surprising that there is much with which Embarq agrees and much with which it disagrees in the numerous comments filed in response to the Reverse Auction Public Notice. Fundamentally, Embarq agrees that there is a need for comprehensive USF reform and that a properly structured reverse auction approach might serve a useful purpose in advancing the goals of the Communications Act of 1934, as amended (the Act). But, as addressed in Embarq's initial Comments, any such comprehensive reform of the explicit USF mechanism must ensure that there

[1] *Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support*, Public Notice, FCC06J-1, WC Docket No. 05-337 (August 11, 2006) (*Reverse Auction Public Notice*)

is "specific, predictable and sufficient" support as required by 47 U.S.C. §254(b)(5) and it must recognize that competition is rapidly eroding the elaborate implicit subsidy system relied upon to foster universal service. As the implicit support erodes, there is greater and greater need for explicit support. Consequently, while Embarq appreciates the Joint Board's and several commenter's apparent concern with controlling the existing fund size,[2] the real challenge will be ensuring that whatever form of reform is undertaken, that the explicit cost recovery system is sufficient to continue to support universal service as it replaces the rapidly eroding system of implicit support the ILEC has used to provide the truly universal service mandated by the Act. Therefore, whatever reform is undertaken, and whether or not it includes reverse auctions, it must recognize these inescapable facts: implicit subsidies have been crucial to producing the level of universal service support now enjoyed, and, this implicit support system cannot be maintained in a competitive market. Consequently, explicit support will necessarily step up to compensate for this loss of implicit support.

Ignoring this linkage between universal service and implicit support leads Verizon and Verizon Wireless to offer the misguided claim that competition reduces the need for universal service subsidies in many areas, and, by implication the

[2] See e.g. Comments of Qwest Communications International Inc., pg. 3 ("Qwest has emphasized certain critical objectives. . . . (1) reducing the overall size of the high cost support fund. . . ."); Comments of the National Cable & Telecommunications Association, pg. 3 ("The continued growth in the size of the fund is a matter of significant concern to the cable industry."); Comments of Verizon and Verizon Wireless, pg. 12 ("The size (and continued growth) of the fund is unsustainable.").

overall size of the fund.[3] Instead, to the extent there is competition in certain areas, it actually erodes the extensive implicit support built into the current pricing and USF system and puts greater pressure on the explicit support system to offset this lost subsidy for those truly high cost areas reliant on the current explicit and implicit support systems to provide service. If, as Verizon and Verizon Wireless opine that "[t]he presence of competitive carriers operating in high cost areas without any support should indicate that subsidies may not be needed in those areas to ensure affordable access,"[4] then the implicit support in those market areas cannot be presumed to be available to offset the high costs in any other market. Accordingly, reforms that continue to rely on averaging and the presumption that the low cost areas are available to offset high cost areas simply perpetuate the problem and place at risk universal service. Instead, explicit sources of support must be increased to offset the implicit support driven out of the competitive markets.

This is not a hypothetical concern. As Embarq's initial Comments indicate, while certain areas may enjoy competitive entry today, market forces alone would not have produced the ubiquitous, reliable communications network this country relies on today. It is only through the ILEC fulfilling its carrier of last resort (COLR) commitments that truly "universal" service exists today. COLR obligations have

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[3] Comments of Verizon and Verizon Wireless, pg. 3.

[4] *Id.*, pg. 10. Of course, as Embarq's initial Comments indicate, competitors do not often choose to build in the truly high cost areas so this situation seldom exists for the area in its entirety. The reality is that competitors build in the low cost, more profitable areas, such as the city center, and avoid the higher cost areas that ILECs are obligated to serve.

required the ILEC to place facilities throughout its entire service territory, even when the cost of doing so far exceeds the revenue it receives from the customer. While ILECs assume the full responsibility of universal coverage and COLR obligations, offering safe, reliable, high-quality service to all customers in its service area, competitive ETCs (C-ETCs) do not share that responsibility and the Commission's and most states' current rules effectively do not require it. Consequently, those high cost areas are largely not areas that competitors choose to serve at all, and certainly not with their own network.

While Verizon and Verizon Wireless' claim that competition will lead to a reduction in the USF fund size is incorrect for the reasons stated above, it is correct that competition leads to the urgent need for reforms. One such reform is to better target support areas. As AT&T suggests:

> The market area for which the universal service obligation is assigned should be relatively small, standard geographic areas. The cost of serving customers differs dramatically, depending on remoteness, topography and population density. Continuing the current practice of lumping together customers from heterogeneous areas for purposes of calculating high cost universal service support . . . would do nothing to address the market distortions and other deleterious effects of implicit subsidies, and deny support to those customers, carriers and areas that need it. Targeting support more granularly to a relatively small geographic area, such as a wire center or a census block group, would ensure that the cost of serving customers in that area is relatively homogenous and that support is directed only those areas where it is needed.[5]

Embarq agrees with AT&T that the current method of calculating support through state-wide averaging or study area averaging builds into the calculation unsustainable implicit support and that a more sustainable calculation will be to

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[5] Comments of AT&T Inc., pg. 13.

target support to a more granular area, such as wire center or even smaller area.[6] By calculating the support at a more granular level, and distributing this more targeted support to smaller geographic areas, the Commission can simultaneously address the problem of eroding implicit support while ensuring that the highest-cost areas continue to receive support that is sufficient, specific, and predictable as required by 47 U.S.C. §254(b)(5).[7]

However, supporting more granular targeting of USF support doesn't negate the realities of how networks are built and customers are served. The calculation and targeted area must recognize the reality of efficient network design and a largely fixed cost industry. That efficient network design mandates that the network be built ubiquitously and building otherwise only makes the economics of serving high-cost areas more problematic, defeating the purpose of guaranteeing that the network reaches all. Being a largely fixed cost industry means losing

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[6] As noted by AT&T, eliminating this averaging may increase the size of the federal fund. *Id.*, pg. 7. But the fact it may increase the fund size doesn't make the proposal wrong. Controlling or capping the fund size cannot be the goal of reform if doing so threatens the Act's requirements to ensure a fund that is "specific, predictable and sufficient" to preserve and advance universal service. Nonetheless, other proposals such as controlling support to duplicative C-ETCs or targeting support to a more granular area may help control the pressure on the size of the fund and still allow the fund to meet the requirements of the Act.

[7] This approach differs significantly from the dis-aggregation paths available to rural companies following rules changes that resulted from the Rural Task Force Order. Those dis-aggregation paths simply allowed for support calculated at the study area level to be distributed at a more a granular level. The more targeted approach suggested herein calculates support at the more granular level.

individual customers does not eliminate costs but drives per access line costs higher for the remaining customers.[8]

Because Embarq and other ILECs have the COLR obligation today and have built networks to fulfill that obligation, any changes to the distribution method, including an auction, must recognize the unique situation of the ILEC. As indicated in our initial comments, while it may be appealing to assume that COLR obligations where network already exists can simply be lifted from the ILEC (somehow allowing the ILEC to be overlooked on universal service funding), it ignores reality. In this regard, Embarq disagrees with AT&T's somewhat cavalier suggestion that the Commission can merely relieve the ILEC of any COLR or other obligations of incumbency, subject to a "reasonable" transition period, such as one year.[9] Good sound-bite but impractical.

First, as indicated, the ILEC already has ubiquitous plant so relieving the ILEC of COLR where network already exists is meaningless. With a network built

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8 AT&T proposes to annually distribute support in a manner that recognizes that the obligation to deploy and maintain a ubiquitous network, ready to provide service throughout an entire area, drives costs that do not disappear simply because a customer opts to go to a competing provider. *Id.*, pg. 14. Embarq agrees with AT&T's premise that legitimate costs remain when customers opt for another provider and that the USF distribution method should recognize this reality.

9 Comments of AT&T, pg. 15. While Embarq believes it is entirely impractical to merely lift the COLR obligation from an ILEC where plant already exists for the reasons stated, if the situation posed by AT&T is nonetheless implemented, Embarq agrees that the ILEC should be relieved of COLR, 47 U.S.C. §251(c), and retail pricing constraints.

and available to serve customers,[10] it may not be practical for the ILEC to walk away from the network and strand the investment. Not walking away, however, means the ILEC may have to attempt to continue to provide service in this area without any explicit support when support was clearly necessary to support the network to begin with.

Second, if the ILEC does get "relieved" of the COLR obligation, when, how, and what exactly happens? If, as AT&T suggests, there is a transition period, is the ILEC expected to maintain the network and invest in the network during the transition, knowing it will not receive support to do so? Moreover, nothing in the Act or rules currently requires an ETC to commit to serving an entire wire center or other study area, using their own network. Instead, ETCs today offer the supported services using either its own facilities or a combination of its own facilities and resale of another carrier's services, including services offered by another ETC.[11] If the ILEC is relieved of its obligation to build and maintain the network, as it must be if it loses the bid, the winning bidder, therefore, must be obligated to serve the entire area through its own investment since it can no longer rely on the network of the ILEC. Nor should it be the expectation that the award of the bid to someone other that the ILEC can be accompanied by a forced sale of

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10 As indicated in Embarq's initial Comments, investment in supporting infrastructure is constantly being added, replaced and maintained as technology advances and new customers are added and new services, including broadband capability, are demanded. For example, analysis conducted on Embarq's serving territory in Texas shows that facilities to serve over 47,000 new customer locations were added in the past three years, despite experiencing overall line loss in Texas of 13%.

11 47 U.S.C. §214(e)(1)(A)

ILEC assets. Leaving aside whether it is legal to do so, how will the sale price be determined when the seller is forced to sell through regulatory fiat and not free market conditions? None of these questions are answered and it is folly to suggest that merely declaring an ILEC "relieved of COLR" negates the need to carefully consider the past and present situation of the ILEC in driving universal service.

Third, removing the COLR obligations only in areas where others want to serve and win a bid—most likely the lower cost areas where competitors may serve without support anyway-- leaves the ILEC with only the less attractive, higher cost areas. In fact, losing the more attractive, lower cost areas actually leaves the ILEC with a higher than before cost profile in the remaining areas as discussed *supra*.

Lastly, the notion of not supporting the ILEC or of an ILEC "losing" an auction fundamentally threatens universal service and competitive choice. Simply put, the ILEC's investment is what universally serves today, not only its own retail customers, but it is used by the customers of other providers. There is little "choice" if changes to the fund result in the one truly ubiquitous provider, the ILEC, being replaced. For example, as indicated in Embarq's initial Comments, the overwhelming majority of customers maintain an ILEC connection and have not chosen to "cut the cord" in favor of a total wireless solution. How acceptable will it be for customers to be forced to periodically substitute providers and perhaps wireless for wireline technology in order to have any hope for service in a high cost area?

Given these considerations, Embarq once again urges the Commission to be deliberate in its consideration of fundamental changes to the USF and to fully explore the goals it seeks to fulfill before it considers how best to accomplish those goals.[12] CTIA stresses a goal of competitive neutrality: "Failure to retain competitively neutral access to high-cost support would relegate consumers in high-cost areas to second-class status—negatively affecting affordability, reasonable comparability and access to advanced wireless services."[13] However, CTIA is mistaken if it believes there is competitive neutrality today. As Embarq's initial Comments point out, wireless C-ETCs operate under different obligations than wireline carriers. If CTIA truly supports competitive neutrality then it should wholeheartedly endorse Embarq's comments to match the COLR obligations, equal access obligations, quality of service requirements, and consumer protection obligations among all ETCs, including wireless carriers.

As the Joint Board gathers facts and weighs proposed changes to the USF program, it must carefully consider what is being achieved today and how. There is little debate that the ILEC's ubiquitous voice network serves as the foundation for the advanced services that are vital to the economic, educational and public

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[12] Unfortunately, the comments of some evidence a fundamental lack of understanding of how the current USF process works. For example, CTIA argues that the current mechanisms are "entirely inconsistent with the goals of universal service" and entitles a section of its comments in support of this proposition "The High-Cost Support Mechanisms Provide Government-Guaranteed Profits and Reimburse Costs Unrelated to Universal Service." *Comments of CTIA—The Wireless Association®*, pg. 2-3. The comments go on to describe a "guaranteed rate-of-return of 11.25%." *Id.*, pg. 3-4. This is simply wrong. The current USF system does not guarantee a profit of 11.25%. The incorporation of a weighted average cost of capital at 11.25% is simply a necessary component of deriving or calculating costs. It is not a profit guarantee. In fact, for price cap carriers in particular, there is no point in the existing USF mechanism where a carrier's revenues are compared to its costs to "guarantee" a profit of 11.25% or any other rate-of-return.

[13] *Id.*, pg. 12

safety needs of America, particularly rural America. The real challenge is to ensure that an explicit universal support system is sufficient, specific, and predictable as competition rapidly erodes the existing system of implicit subsidy that helps support the ILEC network, and the need for explicit support increases. Embarq looks forward to the opportunity to comment further as concrete USF reform proposals are developed.

Respectfully submitted,

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November 8, 2006

CERTIFICATE OF SERVICE

I hereby certify that a copy of Embarq Local Operating Companies' Comments in WC Docket No. 05-337 was delivered by electronic mail or First Class, postage prepaid, U. S. Mail on this 8th day of November 2006 to the parties below and on the attached list.

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