

**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	)	
Seeks Comment on the Merits of Using Auctions	)	CC Docket No. 96-45
to Determine High-Cost Universal Service	)	
Support	)	

**REPLY COMMENTS OF T-MOBILE USA, INC.**

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T-Mobile USA, Inc. (“T-Mobile”) submits this reply to the initial comments filed in response to the Reverse Auction Public Notice released by the Federal-State Joint Board on Universal Service (“Joint Board”).<sup>1</sup> T-Mobile agrees with those commenters supporting the use of “reverse auctions,” or competitive bidding, to identify the recipient or recipients of high-cost universal service support and to determine the level of such support. T-Mobile also concurs with those parties advocating that incumbent local exchange carriers (“ILECs”) be required to bid against all other eligible telecommunications carriers (“ETCs”) participating in the reverse auction process.

**A. Introduction And Summary**

In the Reverse Auction Public Notice, the Joint Board noted that “a compelling reason to use competitive bidding is its potential as a market-based approach to determining universal

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<sup>1</sup> FCC Public Notice, *Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support*, No. 05-337, 2006 FCC LEXIS 4497 (WCB 2006) (“Reverse Auction Public Notice”).

service support, if any, for a given area.”<sup>2</sup> Rather than providing ever-expanding support as an entitlement based on incumbent legacy wireline carriers’ historical costs, reverse auctions would distribute support to the carrier or carriers offering to provide services for the least amount of universal service support. The Joint Board pointed out that, by “selecting the most cost-effective proposal(s), auctions could minimize the burden on customers providing the support.”<sup>3</sup>

The initial comments provide a compelling record for the use of reverse auctions to contain the accelerating expansion of the high-cost universal service fund. By inducing carriers to bid down the current level of support to the actual forward-looking costs of the most efficient bidders, competitive bidding can serve as an effective driver for economically efficient operations. Properly structured reverse auctions will result in universal service support that is “specific, predictable and sufficient.”<sup>4</sup>

These benefits, however, will not be available unless incumbents are required to participate in reverse auctions open to all competitive ETCs. Without the competitive pressures of reverse auctions open to all bidders, the overwhelming portion of the high-cost fund going to incumbents will continue to be divorced from any measure of economic efficiency. Moreover, the principle of competitive and technological neutrality prohibits unequal treatment of different categories of carriers or technologies in the distribution of universal service support. Finally, rural ILECs’ concerns regarding loss of support leading to stranded investment should not deter the Commission from implementing such a promising mechanism. If designed properly to

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<sup>2</sup> *Id.* at \* 3 (quoting *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8948 (1997) (“*First Report and Order*”) (subsequent history omitted)).

<sup>3</sup> Reverse Auction Public Notice, 2006 FCC LEXIS 4497 at \* 5.

<sup>4</sup> 47 U.S.C. § 254(b)(5).

minimize the risk of stranded ILEC investment and other market disruptions, reverse auctions have the potential to be an efficient and equitable mechanism for distributing universal service support.

T-Mobile commends the Joint Board and the Commission for putting forth this creative solution to the vexing problem of unsustainable growth in the high-cost universal service fund and looks forward to working with policymakers to craft a mechanism that advances the public interest in a stable, efficient high-cost fund.

**B. Reverse Auctions Should Be Used To Distribute High-Cost Universal Service Support.**

CTIA - The Wireless Association® (“CTIA”) and other parties explain in their initial comments how reverse auctions would use competition to drive down the cost of high-cost universal service subsidies while furthering important universal service goals.<sup>5</sup> The existing high-cost fund based on embedded costs rewards inefficiency, resulting in rural ILEC (“RLEC”) costs that have increased over time notwithstanding the efficiency gains and technological advances that characterize the rest of the telecommunications industry.<sup>6</sup> Moreover, the RLECs’ elevated profits, fed by ever-increasing universal service support, do not necessarily translate to improved telecommunications services in high-cost areas.<sup>7</sup> A recent study by Professor Thomas W. Hazlett details the excesses enabled by the current high-cost universal service program, with many small RLECs reaping a bonanza of thousands of dollars per line annually in high-cost

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<sup>5</sup> See, e.g., CTIA Comments at 1-5; Seniors Coalition Comments at 1-3. The initial comments in response to the Reverse Auction Public Notice will be cited in this abbreviated manner throughout.

<sup>6</sup> See, e.g., CTIA Comments at 1-4; Seniors Coalition Comments at 1-3.

<sup>7</sup> See, e.g., CTIA Comments at 4-5.

support.<sup>8</sup> Professor Hazlett concludes that high-cost “benefits are largely distributed to shareholders of rural telephone companies, not consumers, and fail . . . to extend network access.”<sup>9</sup>

Reverse auctions have the potential to halt the run-away growth in, and ultimately reduce, the high-cost fund by enabling ETCs to “bid down” the current level of subsidies.<sup>10</sup> Reverse auctions can help target support to the carriers that are able to provide service with the lowest amount of subsidy in the areas where high-cost subsidies are needed.<sup>11</sup> CTIA points out that the industry’s experience with spectrum auctions demonstrates how the use of competitive bidding can provide a powerful incentive to use a scarce resource efficiently. Competitive bidding as a means of establishing the level of high-cost universal service support in a given area promises to bring about similar benefits by reflecting the actual costs of providing service far more accurately than the current burdensome cost reporting requirements.<sup>12</sup>

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<sup>8</sup> Thomas W. Hazlett, “*Universal Service*” Telephone Subsidies: What Does \$7 Billion Buy? at App. 10 (June 2006), available at <http://www.senior.org/USFstudy/> (last visited Nov. 3, 2006) (e.g., annual high-cost support per line of \$13,345 (Sandwich Isles Communications, Inc. - HI); \$6,927 (Accipeter Communications, Inc. - AZ); \$6,515 (Terral Tel. Co. - OK); and \$10,592 (Border to Border Communications - TX)).

<sup>9</sup> *Id.* at cover page.

<sup>10</sup> Verizon Comments at 13.

<sup>11</sup> *Id.* at 2.

<sup>12</sup> CTIA Comments at 5-6. Some commenters claim that, instead of revealing true costs, reverse auction bidders, especially large carriers, will tend to “low-ball” their bids in an effort to drive out potential competitors. See, e.g., NTCA Comments at 10. Carriers, however, are not likely to volunteer to provide services in a given area at a loss for years at a time, driven only by the slim possibility that they could win the next auction with a higher, profitable bid, particularly in light of the “carrier of last resort” type obligations imposed on all ETCs by Section 214(e) of the Act. See ALLTEL Comments at 3. Moreover, hypothetical scenarios of this type of “predatory” bidding implicitly assume a reverse auction process under which “losing” incumbents would be deprived of any and all support. As explained below, a reverse auction

(Footnote continues on next page.)

Moreover, a distribution mechanism based on competitive bidding necessarily awards carriers with “sufficient” support, as required by Section 254(b)(5) of the Communications Act (the “Act”), because they receive the level of support chosen in their reverse auction bids.<sup>13</sup> As Verizon points out, reverse auctions also offer the prospect of a “specific” and “predictable” mechanism through carefully defined auction rules and a definite period of time between auctions, set in advance, during which support would be provided to the winner(s).<sup>14</sup> Thus, reverse auctions based on actual forward-looking costs will drive efficiency, predictability and sustainability, which will, in turn, benefit consumers who rely on the fund for essential communications services.

**C. Incumbent Carriers Should Be Required To Compete Against All Other Bidders In Any Reverse Auction Process.**

Unless incumbent carriers are required to compete against all other bidders, reverse auctions will not bring about these benefits, and high-cost support levels will continue to increase, threatening the goals and very existence of the high-cost universal service program. The Joint Board and Commission should reject RLEC recommendations to exempt incumbents from the reverse auction process or to establish a balkanized auction process separating incumbent ETCs from competitive ETCs (“CETCs”).<sup>15</sup>

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(Footnote continued from previous page.)

system could provide losing incumbents some high-cost support, albeit at a lower level of support than the incumbents receive now. Such an approach would deter predatory bidding by making it unlikely that a losing incumbent would disappear.

<sup>13</sup> See CTIA Comments at 6; Verizon Comments at 21; Qwest Comments at 4-5.

<sup>14</sup> Verizon Comments at 21.

<sup>15</sup> See, e.g., NECA Comments at 13 (only CETCs should be subject to a reverse auction process); OPATSCO Comments at 17-18 (there should be one wireline and one wireless winner in each rural service area).

More than 80 percent of high-cost support currently goes to incumbents.<sup>16</sup> Subjecting only CETCs to the reverse auction process, or a separate process from incumbent carriers, will do nothing to stem the ever-expanding high-cost universal service funding going to the incumbents, particularly to RLECs.<sup>17</sup> Wireless and other competitive carriers are accustomed to cutting costs to meet market demands and would be able to submit competitive bids for high-cost support in a reverse auction setting. Exceptions for incumbents “would necessarily undermine the chief benefits of an auction by distorting, rather than revealing, information about carriers’ costs and the efficient level of subsidy.”<sup>18</sup> Unless incumbents are subjected to the competitive pressures of reverse auctions that are open to all CETCs, it would be “impossible to realize the increased efficiencies and benefits of the market discipline that comes with competitive bidding.”<sup>19</sup> The mechanism proposed by the incumbent commenters would do nothing to cure the deficiencies inherent in the current universal service support process, contravening Congress’s intent that universal service support be “specific, predictable and sufficient.”<sup>20</sup>

Moreover, separate funding for different technologies would not “treat all market participants equally,” thereby violating the principle of competitive and technological neutrality embodied in Section 254(e) of the Act.<sup>21</sup> The point of competitive bidding is to “put all

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<sup>16</sup> See Universal Service Administrative Company, 2005 Annual Report at 41 (showing distribution of high-cost support to incumbent and competitive ETCs in 2005).

<sup>17</sup> See AT&T Comments at 8.

<sup>18</sup> GCI Comments at 16.

<sup>19</sup> AT&T Comments at 7.

<sup>20</sup> 47 U.S.C. § 254(b)(5).

<sup>21</sup> *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 616 (5th Cir. 2000) (“*Alenco*”). See Verizon Comments at 22; AT&T Comments at 8; GCI Comments at 16.

prospective eligible carriers on an equal footing,”<sup>22</sup> but that can happen only if incumbents compete directly against CETCs. The Commission explained that, in establishing the principle of competitive and technological neutrality, it intended

to facilitate a market-based process whereby each user comes to be served by the most efficient technology and carrier. . . . so that no entity receives an unfair competitive advantage that may skew the marketplace or inhibit competition. . . .<sup>23</sup>

Setting aside a separate auction process for incumbents or for wireline carriers would “skew the marketplace” by protecting them from wireless and other competitive bidders, and thereby “inhibit competition.”<sup>24</sup>

**D. Reverse Auctions Can Be Structured to Minimize Stranded Investment.**

RLECs’ and other parties’ suggestions of stranded investment or virtual elimination of rate-of-return regulation if RLECs are forced to compete for high-cost support by becoming more efficient are misguided.<sup>25</sup> All of these arguments assume an all-or-nothing auction system, in which a carrier either wins the bidding and receives support at the level of its bid or loses and receives no support. CTIA suggests a more nuanced approach that may alleviate some of the

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<sup>22</sup> *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 87, 266 (1996) (subsequent history omitted).

<sup>23</sup> *First Report and Order*, 12 FCC Rcd at 8802.

<sup>24</sup> *Id.*

<sup>25</sup> *See, e.g.*, NTCA Comments at 14-15; NECA Comments at 9-14. Commenters also raise other administrative objections, such as the difficulty of ensuring that all bidders will meet the same service quality requirements and determining the geographic area covered by each auction. *See, e.g.*, NTCA Comments at 5-6, 12-13. The Commission, however, already faces these issues today under the existing regime. Because they are inherent in any universal service program, irrespective of the distribution methodology, they are not essential to a decision as to whether to adopt a reverse auction system.

RLECs' concerns. Rather than a "winner take all" approach, CTIA proposes a "winner gets more" auction process.<sup>26</sup> Under this approach, the winning bidder(s) would receive more high-cost support than the losing bidders, but the latter would receive some support, although at a lower level.<sup>27</sup> The Joint Board and Commission could determine how the lesser support for losing bidders, including a losing incumbent, would be calculated.

As a variation on CTIA's suggested "safety net" approach, the Joint Board and Commission might consider awarding some level of support only to the incumbent plus any other ETCs whose bids were within a predetermined "award range," *i.e.*, no more than a certain percentage higher than the lowest bid.<sup>28</sup> Under this alternative approach, all ETCs whose bids were within the award range would receive the same support. For example, the "winning" bidders might receive support at the level of the lowest bid. ETCs whose bids were above that range would receive no support. If the incumbent were above the award range, however, it would still receive support, unlike other losing bidders, but at a lower level of support.<sup>29</sup> Such an approach also would comport with Chairman Martin's acknowledgement of the need to protect and transition RLECs to a new universal service support distribution system.<sup>30</sup>

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<sup>26</sup> CTIA Comments at 8.

<sup>27</sup> *Id.* at 8-9.

<sup>28</sup> See also D. Weller, *Auctions for Universal Service Obligations* (June 1998), for an additional variation on this approach.

<sup>29</sup> Determination of the award range and lower level of support received by a losing incumbent should maximize the incumbent's incentives to submit a low bid while minimizing the threat of stranded investment or the need to make incumbent facilities available to the winner(s).

<sup>30</sup> *Net Neutrality, 'Reverse Auctions' Among Concerns in Martin Renomination Hearing*, TR Daily (Sept. 13, 2006).

In any event, whether the Joint Board and Commission choose a more restricted “winners’ circle” within a specified award range or award some level of support to all bidders, as CTIA suggests, this safety net should achieve the Commission’s universal service goals while generating the hoped-for efficiency incentives among incumbents with minimal disruption.<sup>31</sup> The safety net also should minimize any threat to a rate-of-return (“ROR”) ILEC’s earnings resulting from a losing bid, thereby ensuring against the risk of stranded investment. An RLEC facing reduced revenues after losing a bid is also free to take additional steps to close the remaining gap, such as offering new services, cutting costs through greater efficiencies and reducing dividend payouts.

The possibility that an RLEC still might not be able to earn its authorized ROR following a reduction in its high-cost support, however, is no reason to reject reverse auctions as a high-cost universal service support distribution mechanism. An inability to earn the authorized ROR is not equivalent to eliminating ROR regulation because a “carrier is guaranteed only the opportunity to earn the authorized [rate of] return, not the return itself.”<sup>32</sup> Moreover, “[s]o long as there is sufficient and competitively-neutral [universal service] funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well.”<sup>33</sup>

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<sup>31</sup> To the extent that a reverse auction system would generate pressure on incumbents to cut costs by reducing service quality, as some parties allege (*see, e.g.*, NTCA Comments at 7-8), a safety net approach would reduce that pressure by awarding losing incumbents some support.

<sup>32</sup> *GTE Telephone Operating Companies’ Request for Waiver of Section 65.703*, 2 FCC Rcd 5948 (CCB 1987), citing *FPC v. Hope Natural Gas Company*, 320 U.S. 591 (1944) and *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942).

<sup>33</sup> *Alenco*, 201 F.3d at 620.

A primary goal of any reverse auction process is to spur incumbents to achieve greater efficiencies. If the Joint Board and Commission were to adopt a safety net approach along the lines suggested here, with auction “winners” and “losers,” incumbents eventually would be expected, after a reasonable transition period, to submit bids that would not be given any special treatment. For example, in the second reverse auction, if an incumbent fails a second time to submit a winning bid, *i.e.*, a bid that fell within the award range, its support could be reduced to a greater degree than in the first auction. If the incumbent’s bids continue to fall outside the award range in subsequent auctions, support could be reduced further until the incumbent received no special consideration.

Contrary to the arguments of some commenters,<sup>34</sup> awarding support to two or more ETCs should not impose a drain on the high-cost fund if all recipients receive support solely on a per-line basis. Thus, the incumbent would lose support for every access line it lost, just as in the case of all other ETCs losing subscribers. By spurring ETCs to bid down the current level of per-line high-cost support and reducing support for every line lost to a competitor, a reverse auction approach should generate significant savings over the current system.

Finally, this safety net approach is far superior to the model proposal attached to the Reverse Auction Public Notice. Under that model, the incumbent would continue to receive the same excessive level of support that it has enjoyed under the current system for ten more years.<sup>35</sup> Continuation of the same level of ILEC support -- now four-fifths of the high-cost fund -- for any period of time, let alone a decade, would defeat the cost-saving and competitive purposes of a reverse auction and would sentence the universal service fund to unending growth.

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<sup>34</sup> *See, e.g.*, Verizon Comments at 13, 25-26.

<sup>35</sup> Reverse Auction Public Notice, 2006 FCC LEXIS 4497 at \* 20-22.

## **E. Conclusion**

Reverse auctions promise an efficient and competitively and technologically neutral method of distributing high-cost universal service support as long the incumbent serving each area to be covered by an auction is required to face all other ETCs bidding for support for that area. If incumbents are insulated from the reverse auction process entirely or a separate auction is conducted for all wireline carriers, the resulting distribution of support will not be competitively or technologically neutral.

Moreover, providing some level of support during a transition period for incumbents submitting losing bids should ameliorate any potential concerns that incumbents will be forced to abandon operations. T-Mobile encourages the use of reverse auctions as a means to reform the current inefficient and unfair high-cost universal service distribution mechanism and looks

forward to continued work with policymakers and the industry to ensure the sustainability of an efficient universal service fund.

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