

**ORGANIZATION for the PROMOTION and
ADVANCEMENT of SMALL
TELECOMMUNICATIONS COMPANIES**



O P A S T C O

***Ex Parte* Presentation**

Cmmr. John Burke, VT Public Service Board

WC Docket No. 05-337

CC Docket No. 96-45

January 4, 2007



SUMMARY

- **Reverse auctions should not be used to determine high-cost support in rural service areas.**
- **High-cost support for rural ILECs should continue to be based on their embedded network costs.**
- **The identical support rule should be eliminated in rural service areas and support for competitive ETCs should be based on their own costs.**



OPASTCO

REVERSE AUCTIONS

- **Reverse auctions should not be used for determining high-cost support eligibility and amounts in rural service areas.**
- **Reverse auctions create the wrong incentives and pose too many risks to the continued availability of “reasonably comparable” services and rates to all consumers in rural service areas.**



OPASTCO

REVERSE AUCTIONS

- **Reverse auctions fail to naturally encourage network upgrades.**
 - **Rural carriers will not make significant investments in network infrastructure without a reasonable expectation that costs can be fully recovered. If the remainder of an auction term is not long enough to recover the cost of a needed upgrade, it is unlikely that the investment will be made.**
 - **Even if implementation of auctions is delayed for rural ILECs, they will still be reluctant to invest in their networks during the transition period. They also may not have an opportunity to fully recover the cost of investments that have already been made.**
 - **There is nothing to prevent deep-pocketed, urban-based carriers from “low balling” their bids to ensure they win an auction. These carriers would then likely commit the bare minimum of resources to the high-cost portions of the service area.**



OPASTCO

REVERSE AUCTIONS

- **Reverse auctions would threaten the outlook that lending institutions have of the stability and predictability of rural ILECs' core cash flows, which is the essential underpinning of most current loan structures.**
- **Reverse auctions would make lenders more reluctant to make financing available to rural ILECs due to the increased risk of stranded investment. At the very least, it would raise the cost of capital.**



OPASTCO

REVERSE AUCTIONS

- **Reverse auctions fail to provide a “backup” in the event that the winning bidder fails to meet established performance requirements.**
 - **If the rural ILEC is not selected as an auction winner, the loss of high-cost support could cause irreparable harm and make it impossible for them to step back in to provide service to the highest cost customers. Some rural ILECs may even seek to exit the market entirely.**
 - **Absent another carrier capable of serving as the universal service provider, either the performance expectations of the winning bidder would have to be renegotiated downward or the support amount would have to be renegotiated upward. End-user rates may also have to increase.**
 - **The availability of advanced services could also be seriously compromised, as rural ILECs are often the only providers of broadband service throughout their service areas.**



OPASTCO

RURAL ILEC SUPPORT

- **High-cost support for rural ILECs should continue to be based on their embedded network costs.**
- **Support based on embedded costs has been highly successful in enabling rural ILECs to achieve the statutory objectives of “reasonably comparable” services and rates throughout their rural service areas.**
- **Support based on embedded costs has been instrumental to rural ILECs’ ability to deploy the multi-functional infrastructure capable of providing broadband.**
 - **Without a direct link between the cost of network investments and support amounts, rural ILECs would be reluctant to make substantial network upgrades, particularly those necessary to offer advanced services.**



OPASTCO

RURAL ILEC SUPPORT

- **Rural ILECs have strong incentives to operate efficiently and invest prudently under a support mechanism based on embedded costs.**
 - **High-cost support recovers only a portion of rural ILECs' costs.**
 - **Rural ILECs operate in a competitive environment and must respond to threats from wireless carriers, VoIP providers, and competitive access providers, among others.**
 - **Rural ILECs' costs and operations undergo significant scrutiny and oversight from auditors, regulators, lenders and shareholders.**



OPASTCO

CETC SUPPORT IN RURAL SERVICE AREAS

Rural High-Cost Support Program	1 st Quarter 2005 Support	1 st Quarter 2006 Support	1 st Quarter 2007 Support	% Change 1Q 2005 – 1Q 2007	Dollar Change 1Q 2005 - 1Q 2007	% of Total Two-Year Support Increase
(\$Millions)						
Rural ILEC	\$621.6	\$622.6	\$623.8	0.35%	\$2.2	2.6%
CETC	\$109.8	\$158.6	\$191.5	74.4%	\$81.7	97.4%
Total	\$731.4	\$781.2	\$815.3	11.5%	\$83.9	100.0%

- **USAC Fund size projections illustrate that competitive ETCs have been responsible for almost all of the growth in the rural High-Cost program over the past two years, while rural ILEC support has remained essentially flat.**

Note: Data derived from USAC's Federal Universal Service Support Mechanisms Fund Size Projections for First Quarter 2005, 2006, and 2007, Appendix HC01. The data focuses solely on projected support for ILECs and competitive ETCs in rural telephone company study areas. The support amounts for competitive ETCs reflect both existing competitive ETCs as well as competitive ETC applications that are pending.



OPASTCO

CETC SUPPORT IN RURAL SERVICE AREAS

- **The rapid growth in competitive ETC support in rural service areas is a result of the identical support rule, which creates arbitrage opportunities for carriers to seek ETC status in order to receive windfalls of support that exceed “sufficient” levels.**
- **Equal support for carriers that have stark differences in service area coverage, service quality, and regulatory requirements is not competitively neutral.**
- **The Joint Board should target the source of unnecessary growth in the rural High-Cost program by recommending the elimination of the identical support rule in rural service areas and that support for competitive ETCs be based on their own costs.**



OPASTCO

CETC SUPPORT IN RURAL SERVICE AREAS

- **Cost-based support for competitive ETCs in rural service areas would introduce the same rationality and accountability into the mechanism for these carriers that already exists for rural ILECs.**
 - Results in payments that are “sufficient,” but not more so, and “specific” to each carrier’s own circumstances, consistent with Sec. 254(b)(5) of the 1996 Act. It ensures that only those carriers that demonstrate above-average costs that exceed a certain threshold receive funding.
 - Promotes compliance with the Sec. 254(e) requirement that support only be used for the provision, maintenance and upgrading of facilities and services. Like rural ILECs, support would be received only after legitimate costs have been incurred.
 - Promotes efficient competitive entry in high-cost areas, since carriers would no longer have perverse incentives to seek ETC status merely to receive windfall support payments.



CONCLUSION

- **The use of reverse auctions in rural service areas would needlessly abandon the highly successful embedded cost basis of support for rural ILECs, in the process of excising what is clearly not working: the identical support rule for competitive ETCs.**
- **The Joint Board should focus on reforms that pinpoint the root cause of unnecessary growth in the rural High-Cost program while avoiding recommendations, such as auctions, that jeopardize the continued provision of universal service to consumers in rural service areas.**
- **Cost-based support for competitive ETCs in rural service areas would effectively address the wasteful payout of windfall support amounts that threaten the Fund's viability. At the same time, all ETCs would receive sufficient support to enable the continued achievement of the universal service objectives of Congress and the FCC.**



SUMMARY

- **Reverse auctions should not be used to determine high-cost support in rural service areas.**
- **High-cost support for rural ILECs should continue to be based on their embedded network costs.**
- **The identical support rule should be eliminated in rural service areas and support for competitive ETCs should be based on their own costs.**



OPASTCO

CONTACTS

OPASTCO

21 Dupont Circle NW, Suite 700
Washington, DC 20036
Phone: (202) 659-5990
Fax: (202) 659-4619

OPASTCO Staff

John Rose, President
jnr@opastco.org

Stuart Polikoff, Dir. of Government Relations
sep@opastco.org

Randy Tyree, Dir. of Legislative and Industry Affairs
rxt@opastco.org

Stephen Pastorkovich,
Dir. of Business Development/Senior Policy Analyst
sfp@opastco.org

Brian Ford, Policy Analyst
bjf@opastco.org

2006 OPASTCO Officers

Chad Miles, Chairman
Enhanced Telecommunications Corp.
Sunman, IN
812- 623-2122, cmiles@etc1.net

Roger Nishi, First Vice Chairman
Waitsfield & Champlain Valley Telecom
Waitsfield, VT
802-496-8336, rnishi@wcvt.com

H. Keith Oliver, Second Vice Chairman
Home Telephone Company, Inc.
Moncks Corner, SC
843-761-9100, keitholiver@hometelco.com