Universal Service Reform

Federal-State Joint Board on Universal Service

February 17, 2007

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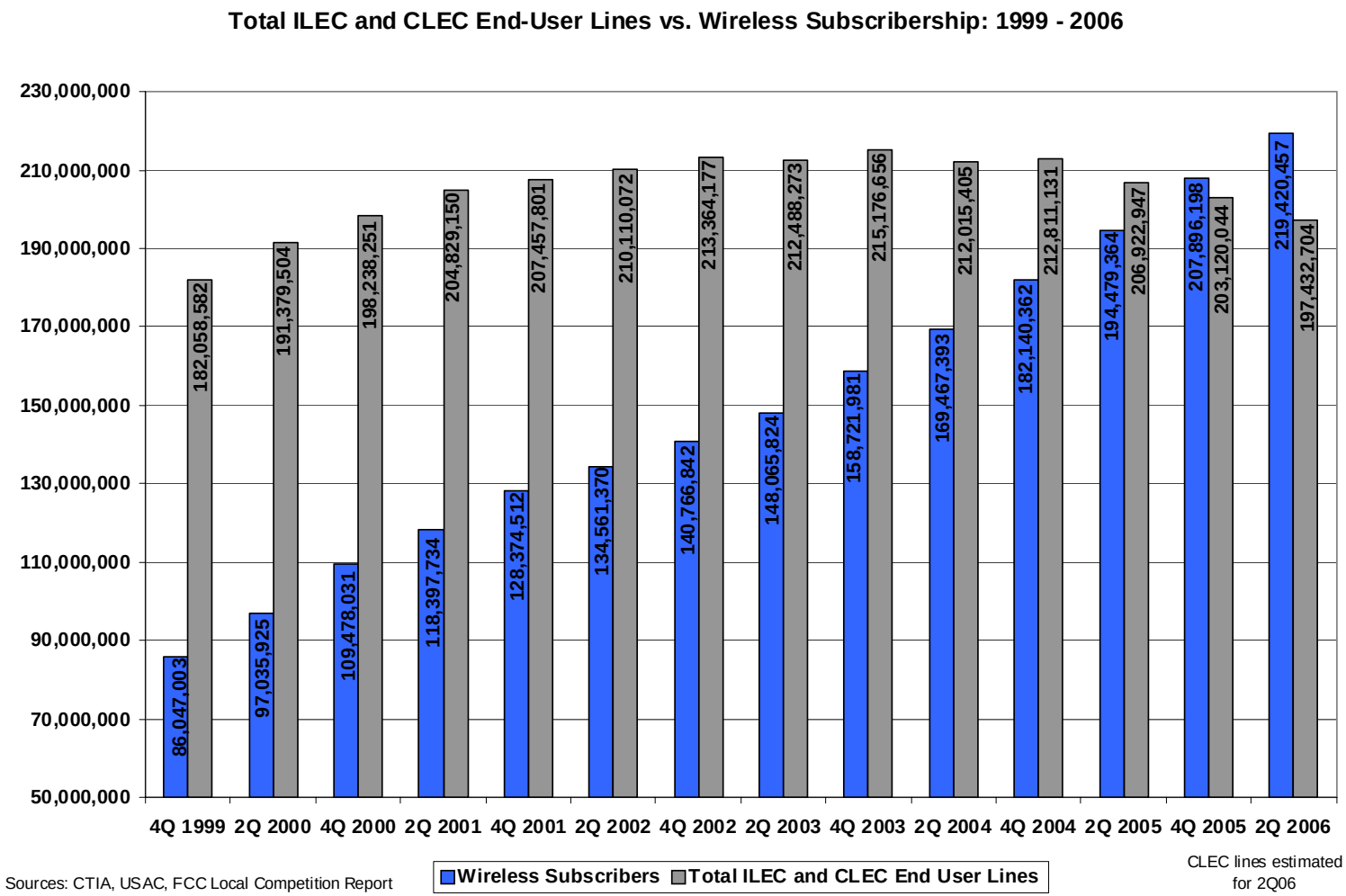
Companies Represented

- U.S. Cellular Corp.
- Alliance of Rural CMRS Carriers
  - Rural Cellular Corp.
  - Viaero Wireless
  - Easterbrooke Cellular
  - Smith Bagley, Inc.
  - Swiftel
  - Airadigm
  - MTPCS, Inc.
  - Cellcom

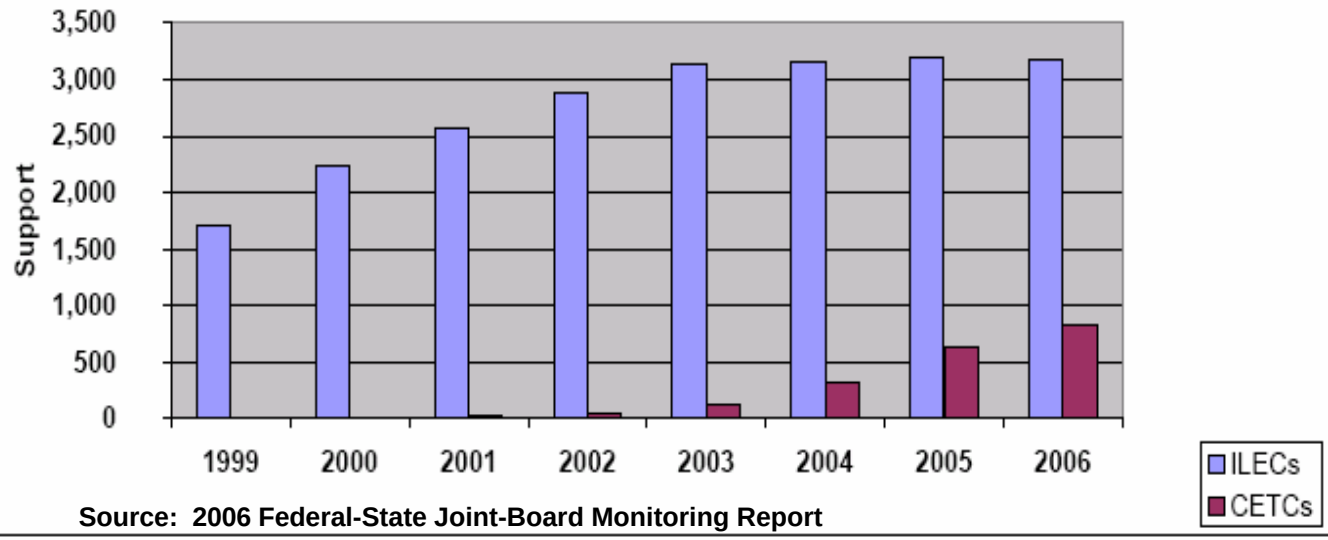
Wireless Subscribership Has Passed Wireline



Sources: CTIA, USAC, FCC Local Competition Report

CLEC lines estimated for 2Q06

Chart 3.2
Total High-Cost Support Fund Payments - ILECs and CETCs
(In Millions of Dollars)



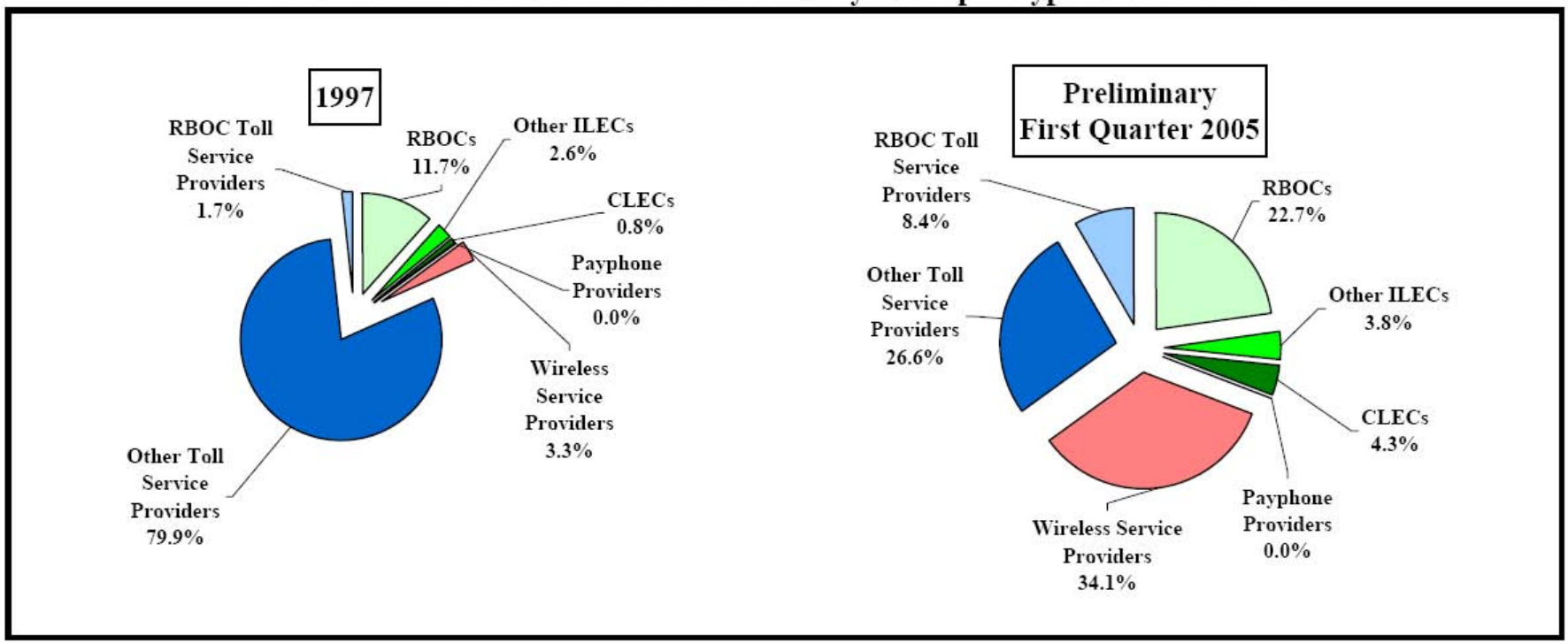
Source: 2006 Federal-State Joint-Board Monitoring Report

Total High-Cost Support 1999-2006:

ILEC: $22,054,700,000
CETC: $1,969,200,000

Wireless Consumers Share of Contributions: Over $2.5 Billion Available for Distribution in 2005 and Rising

Chart 19.8
Share of Universal Service Contributions by Principal Type of Contributor



Source: Trends in Telephone Service, 2005 Report (Most Recent Publication)

Summary of Slides 3-5

- Wireless has irretrievably passed wireline nationwide.
- Close to 10% of households are now “wireless only.”
- Rural access lines have decreased 10%, but support remains steady.
- Since 1996, wireline draws in the aggregate outstrip wireless 10-1.
- Wireless consumers’ contributions will increase as new 37.1% contribution factor is implemented.
- Rural consumers, who have relatively poor wireless service away from major towns and highways, are only now beginning to see the benefits of investment from CETCs.

Objectives for Federal Universal Service Reform

- To provide rural consumers with choices in services and service providers similar to those available in urban areas (Section 254)
  - Choices can only be provided if infrastructure is in place.
  - The 1996 Act goes far beyond simply providing connections to the network.
- To develop competitively neutral reforms that permit evolution to a near-future in which most rural consumers use wireless as their primary tool for voice communication.
  - Recognize that wireless is the future of voice in rural areas.
  - Transition to a wireless future requires mechanisms that require all classes of carriers to compete for consumers and support.
  - Wireline carriers will remain viable as IP/Video/Ancillary platforms.
- To improve service quality for rural consumers by increasing service availability.
  - For many rural consumers today, service availability **IS** quality service.
- To provide rural areas with the critical health/safety benefits of wireless.
  - As Katrina demonstrated, wireless is critical to post-disaster communications.

Competitive Neutrality

- The FCC adopted competitive neutrality as a “core” universal service principle.
- FCC: “Our decisions here are intended to minimize departures from competitive neutrality, so as to facilitate a market-based process whereby each user comes to be served by the most efficient technology and carrier. We conclude that competitively neutral rules will ensure that such disparities are minimized ***so that no entity receives an unfair competitive advantage that may skew the marketplace or inhibit competition by limiting the available quantity of services or restricting the entry of potential service providers.***” (First Order).
- Proposals to “control” growth of the fund by restricting access by, or support to, competitive carriers must be rejected.

Short Term – Three Critical Reforms Before Reverse Auctions are Implemented.

- Disaggregation: Rural ILECs Must Accurately Target Support to Areas that Are “High-Cost” for Their Networks.

- Portability: Support to Rural ILECs Must Be Made “Fully Portable”

- Efficiency: Support to Rural ILECs Must Not Exceed the Actual Cost of Building an Efficient Network.

I. Disaggregation

- Identifying and targeting support to high-cost areas is the foundation of effective reform.
- RTF White Paper #6 indicated ‘consensus’ on merits of disaggregation.
- The FCC’s rules do not require disaggregation upon CETC designation. 47 C.F.R. Section 54.315.
- Only 10% of rural ILECs disaggregated support.
- Allowing CETCs to capture an “average” level of support in low-cost areas invites arbitrage.
- FCC has ruled that disaggregation resolves cream-skimming concerns.
- Cream-skimming is a real issue if CETCs are not designated.
- Rural ILECs MUST disaggregate, at least to the wire center level, upon CETC entry.

Disaggregation Explained

Highland Cellular example:

Table 1

Wire Center Name	Number of Customers	Support Available	Total
Athens	686	$11.92	$8,177.12
Bluefield	**3,470**	**$11.92**	**$41,362.40**
Bluewell	640	$11.92	$7,628.80
Bramwell	113	$11.92	$1,346.96
Matoaka	239	$11.92	$2,848.88
Oakvale	198	$11.92	$2,360.16
Princeton	**4,521**	**$11.92**	**$53,890.32**
Frankford	282	$37.72	$10,637.04
Rupert	27	$16.80	$453.60

Total Without Disaggregation: $128,705.28

Disaggregation Explained (cont'd)

Highland Cellular example:

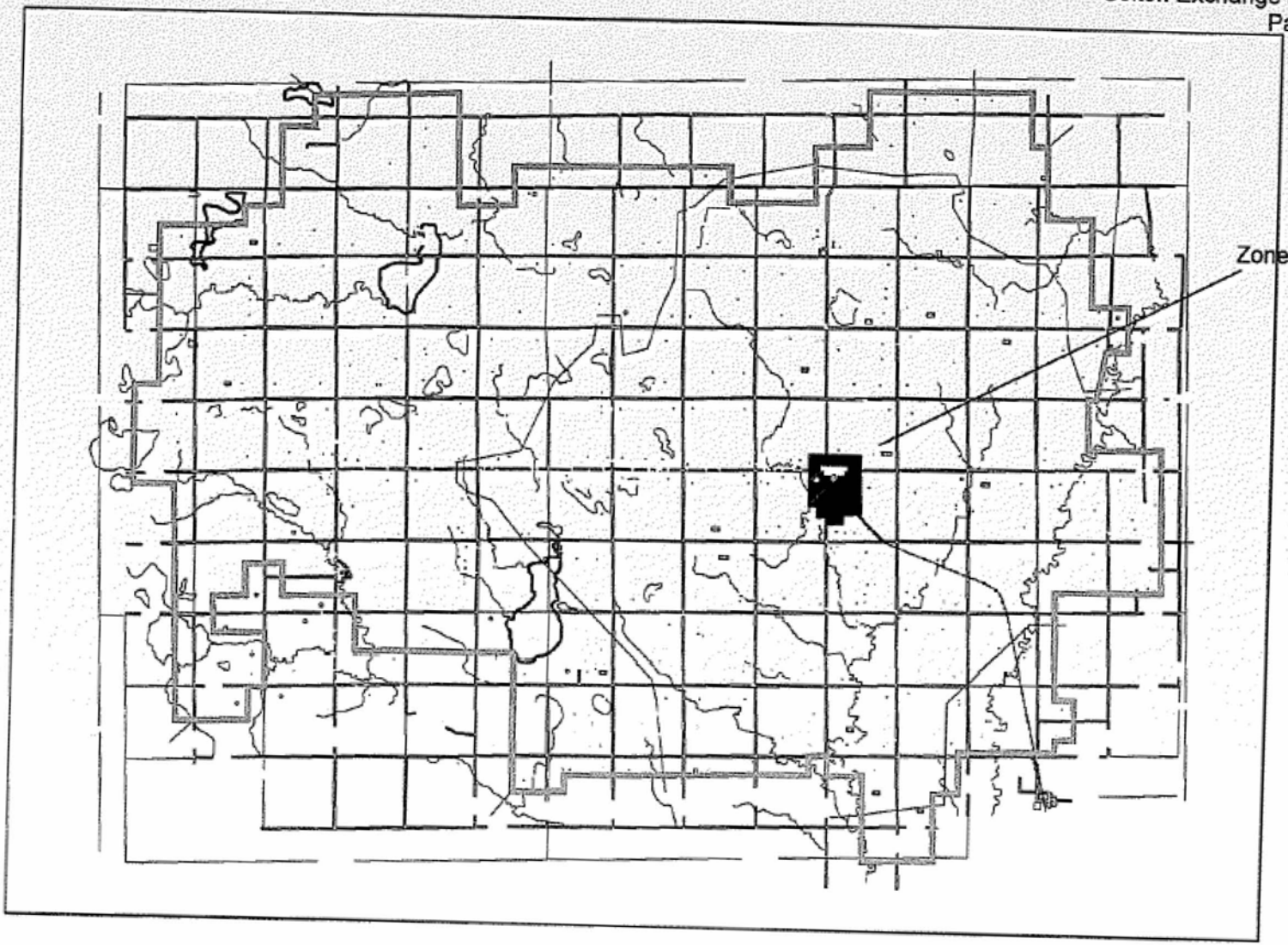
Table 2

Wire Center Name	Number of Customers	Support Available	Total
Athens	686	$38.24	$26,232.64
Bluefield	**3,470**	**$0.00**	**$0.00**
Bluewell	640	$20.44	$13,081.60
Bramwell	113	$20.44	$2,309.72
Matoaka	239	$38.24	$9,139.36
Oakvale	198	$38.24	$7,571.52
Princeton	**4,521**	**$0.00**	**$0.00**
Frankford	282	$34.04	$9,599.28
Rupert	27	$23.80	$642.60

Total With Disaggregation: $68,576.72

USF Disaggregation
Zone 1 = Entire Exchange less Town of Colton
Zone 2 = See page 2 of 9 for details

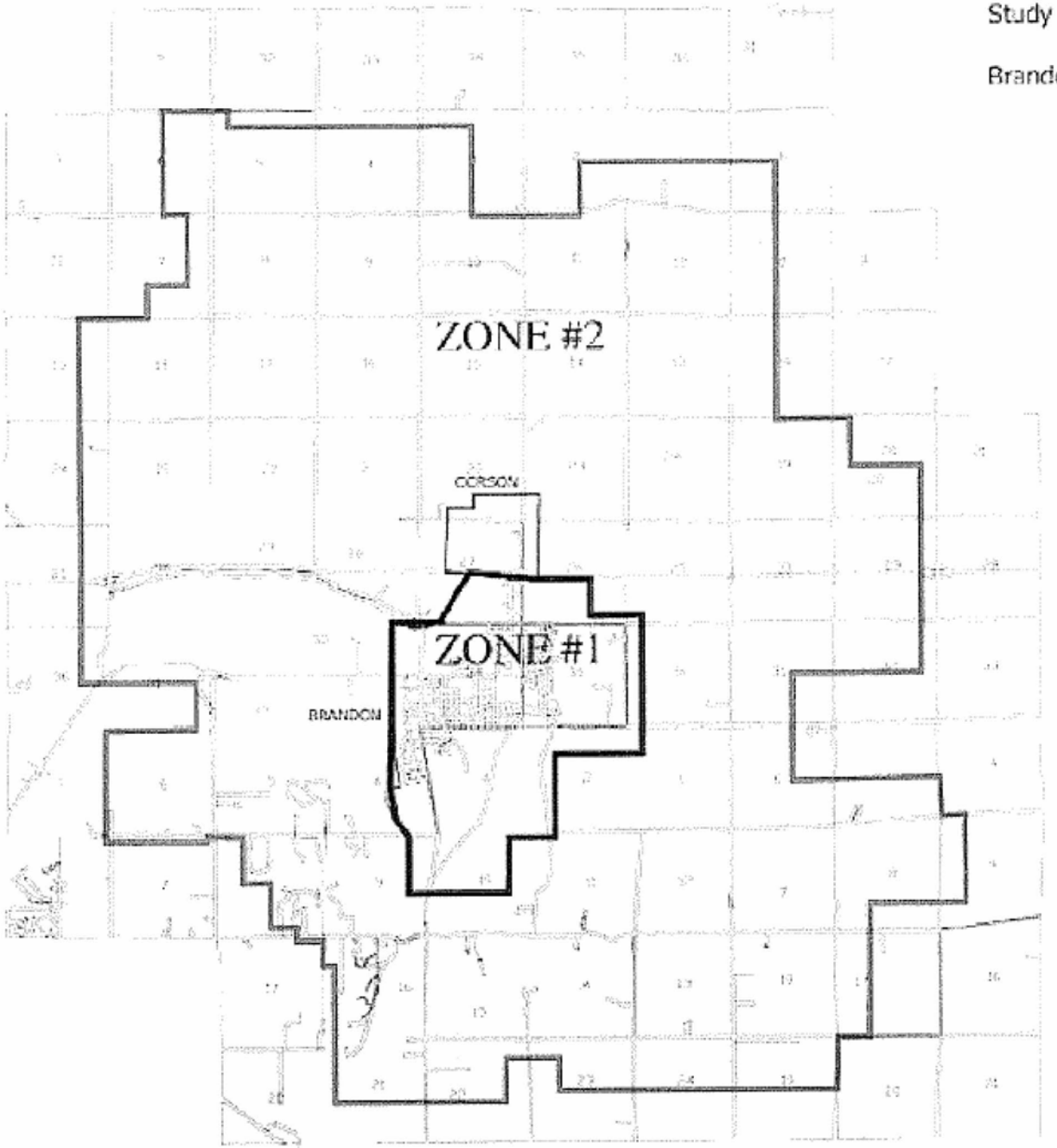
Sioux Valley Telephone Company
USAC No. 391677
Colton Exchange Boundary



0 60,000 120,000 240,000 360,000 480,000
Miles

Splitrock Telecom Cooperative, Inc.
Study Area Code: 391657

Brandon Exchange



Advantages of Disaggregation

- Targeting support to consumers in highest-cost areas, who need it most, serves the public interest.
- Removes arbitrage opportunity by ensuring no carrier gains subsidy for serving customers in low-cost areas.
- Identifying high-cost areas provides incentives for efficient carriers to enter.
- Support to incumbents not affected.
- Support to competitors could drop 10-40% in near-term.

II. Portability of Support

- Full portability must be implemented in order to control growth of the fund.
- Alenco: Portability is required by statute.
- “So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act….”
- “The purpose of universal service is to benefit the customer, not the carrier. ‘Sufficient’ funding of the customer's right to adequate telephone service can be achieved regardless of which carrier ultimately receives the subsidy.”
- FCC’s goal to make support for rural ILECs fully portable is not yet realized.

Portability of Support (cont'd)

- Identical support rule is competitively neutral:
  - "To ensure competitive neutrality, we believe that a competitor that wins a high-cost customer from an incumbent LEC should be entitled to the same amount of support that the incumbent would have received for the line, including any interim hold-harmless amount…Unequal federal funding could discourage competitive entry in high-cost areas and stifle a competitor's ability to provide service at rates competitive to those of the incumbent." Ninth R&O.
- All support that is made "explicit" is, by definition, high-cost support. As such, it must be portable.
- Regulators must ensure that support provided to all carriers is invested as required by Section 254.
- Full portability is critical to controlling fund growth.
- A record to determine when to implement full portability must be developed.
- Requiring carriers to compete for customers and support will drive consumer benefits.

III. Efficiency

- The Commission has repeatedly stated its intention "to transform universal service mechanisms so that they are both sustainable as competition in local markets develops, and explicit in a manner that promotes the development of efficient competition across the nation." Seventh R&O.
- There is no record demonstrating how much support rural ILECs can lose before they reduce investment or raise prices.
- The problem of inefficiency is illustrated by:
  - Combination of rate of return regulation and modified embedded cost system of support breeds widely-reported inefficiencies (the more you spend, the more you get.)
  - Widely reported irregularities in dividend payments, gold-plating, under-pricing of basic service, and inflation of overhead.
  - Since 2003, ILEC high-cost support is steady, while access line counts have dropped 10%.
  - "Competitive destruction," absent in rural areas, harms consumers.
  - NTCA comment in MB Docket 06-189 (11/29/06) on shared head-ends demonstrates how carriers seek efficiencies in competitive markets.

III. Efficiency (cont'd)

- Irregularities in use of support are best policed by market forces.
  - Regulators cannot effectively determine whether an investment is efficient or necessary.
- Support should not exceed the actual cost of building an efficient wireline network.
  - Developing updated methodologies should be undertaken.
- A solution that is competitively neutral and promotes efficiency: Target a fully portable and sufficient per-line amount to high-cost areas.
  - Requiring all carriers to compete for customers and support will drive consumer benefits and accelerate the delivery of advanced services to rural areas.

Portable Per-Line Support Limits Fund Growth

- Drives efficient competitive entry: competitors must assess customer and support revenue streams before entering.
- Investment must be made first and is 100% at risk, which punishes inefficient investment. If you lose a customer, you lose support.
- Market-based cap on support to an area. Same support is provided in highest-cost wire centers no matter how many CETCs are designated.
- Removes from regulators the need to pick winners or limit number of entrants.
- In a high-cost area, the effect on fund is the same irrespective whether one CETC or several CETCs are designated.
- Subsequent entrants either do not choose ETC status or they must resell to meet ETC obligations.

Reverse Auctions

- Long-term, reverse auctions can promote competitive neutrality and efficiency:
  - Newcomers must have opportunity to construct networks that are competitive with incumbents.
  - All carriers must participate. No class of carrier can be excluded from an auction.
  - Choosing one winner (or one CETC winner) contravenes Sections 214 and 254, would not be competitively neutral, and fails rural consumers.
  - All carriers willing to provide service within some % of auction winner must be eligible to enter and compete.

Carrier of Last Resort Obligations

- COLR obligation is the same for all carriers at the federal level: all carriers are obligated to provide service on reasonable request.
- No evidence that ILECs, with over $3 billion of support provided annually, will abandon rural areas if the above-proposed reforms are implemented.
- States are authorized to mandate service to a requesting customer and are experienced in ensuring that the carrier required to provide service earns a reasonable return.

Summary

- The FCC has made no progress in modernizing universal service distributions for rural ILECs since committing to do so in 2001. Now is the time.
- Implementing much of what was done in the non-rural context can be done quickly, with significant and positive effects.
- The steps outlined above may obviate the need for auctions by stabilizing the size of the high-cost fund in a competitively neutral fashion.
- At the very least, these steps can be implemented as an interim measure until reverse auctions can be examined more closely.