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March 5, 2007

Via ECFS

Hon. Deborah Taylor Tate
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

Hon. Ray Baum
Oregon Public Service Commission
550 Capitol Street, N.E., Suite 215
P.O. Box 2148
Salem, OR 97308

Re: CC Docket No. 96-45
WC Docket No. 05-337

Dear Commissioner Tate and Commissioner Baum:

On behalf of Cellular South Licenses, Inc. ("Cellular South"), we write to provide you with an initial response to the proposal for reverse auctions submitted by Verizon and Verizon Wireless (collectively, "Verizon") on February 9, 2007 via ex parte submission to the FCC.

While not ruling out auctions entirely, Cellular South opposes the Verizon plan. Put simply, the plan is not worthy of serious consideration and reflects a calculated effort to place all of the near-term universal service burdens on wireless carriers and consumers, while protecting the wireline industry from having to meaningfully contribute to fulfilling the objectives set forth by Congress to advance universal service in rural America. As such, it should be rejected.

Cellular South, through its participation in the Alliance of Rural CMRS Carriers ("ARCC") and its other advocacy efforts, has offered to the Joint Board far superior proposals that would accomplish most of the goals stated in Verizon's submission within the existing universal service framework.[1] These reforms, which can be implemented relatively quickly, would spread the burdens and benefits much more equitably among those who contribute to and draw from the fund and provide rural consumers with the benefits Congress intended to deliver.

Our comments on Verizon's plan are as follows:

[1] See, e.g., ARCC's ex parte presentation in the above-referenced dockets, filed January 23, 2007.

1. Under Verizon's Plan, Only 90 of 1400 Wireline Study Areas Would be Subject to Auctions.

Verizon's plan only requires carriers using the same technology to participate in auctions. For example, wireless ETCs would participate in an auction against each other, but not against wireline ETCs. According to Verizon, there are only about 90 wireline study areas that have wireline CETCs designated, out of approximately 1400 total. It is likely the number is so low because wireline competition has come to only those areas that are lower cost and more lucrative to serve, not the nation's most rural areas.

Whatever the reason, roughly 1300 wireline study areas, including virtually all rural ILEC study areas, would not be subject to auctions *indefinitely*. This means rural wireline carriers would continue to be funded by a mechanism that provides support on a "the more you spend, the more you get" basis, with little or no oversight of whether expenditures are appropriate or necessary.[2]

Beyond our nation's metropolitan areas, ILECs face very little competition from other wireline carriers, primarily because the incumbent's network was constructed over many decades, all the while being the only provider receiving subsidies. The FCC specifically identified this situation as a barrier to competitive entry when it stated:

> A mechanism that provides support to ILECs while denying funds to eligible prospective competitors thus may give customers a strong incentive to choose service from ILECs rather than competitors. Further, we believe that ***it is unreasonable to expect an unsupported carrier to enter a high-cost market and provide a service that its competitor already provides at a substantially supported price.*** In fact, such a carrier may be unable to secure financing or finalize business plans due to uncertainty surrounding its state government-imposed competitive disadvantage. Consequently, such a program may well have the effect of prohibiting such competitors from providing telecommunications service, in violation of section 253(a).[3]

Plainly, Verizon's proposal for auctions among competitors, but not incumbents, constructs an illegal barrier to competitive entry under Section 253 of the Act.

Given the fact that rural ILECs have lost 10% of their access lines over the past three years but continue to receive over $3 billion in support, this is a recipe for enormous waste and inefficiency. If, for example, rural ILECs lose 40% of their access lines over the next five years,

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[2] *See* Thomas W. Hazlett, "'Universal Service' Telephone Subsidies: What Does $7 Billion Buy?" (June 2006) at pp. 25-36 (describing the disproportionate share of rural ILECs costs attributed to corporate overhead expenses, and the resulting payment of "stunningly high" per-line subsidies to rural ILECs).

[3] Western Wireless Corporation Petition For Preemption Of Statutes And Rules Regarding The Kansas State Universal Service Fund Pursuant To Section 253 Of The Communications Act Of 1934, 15 FCC Rcd. 16,227 (2000), at para. 8 (emphasis added).

while still receiving over $3 billion in support, rural consumers will be subject to an enormous injustice. Universal service support should not be based on inefficient, legacy technologies that would not be used to build out a new network today. Currently, large carriers (e.g., Verizon, AT&T) receive support based on a model designed to provide support on the cost of building an efficient network. The Commission should encourage the development of a model that provides support to all carriers operating in rural areas based on the cost of building a network using the most efficient technology available.

Rural consumers are demanding high-quality wireless networks and are increasingly choosing these networks as their primary means of communications. Support must flow with the services that consumers are increasingly choosing. Rather than address this reality, Verizon's plan perpetuates the current and broken system for over 90% of ILECs. The ARCC plan provides meaningful near-term reform within the current regulatory framework, consistent with the 1996 Act and the FCC's clear policy direction as contained in its many post-1996 Act orders.

The Commission must do what it has repeatedly said it was going to do: reform universal service mechanisms for rural areas so as to more accurately target support and implement long-term solutions that are consistent with the 1996 Act.[4] When fully implemented, this will provide rural consumers with choices in telecommunications services.

2. Verizon's Plan Distorts the Competitive Marketplace and Denies Consumers the Benefits Promised in the 1996 Act.

Determining a single auction "winner" fails to advance the dual goals required by the 1996 Act – to promote competition and advance universal service. The 1996 Act promised all consumers, not just those in urban areas, choices in telecommunications services.[5] Instead of providing consumers with the opportunity to choose, Verizon's plan distorts the market, perpetuating the problem of newcomers with innovative technologies having to compete against a subsidized carrier. This is also contrary to the Commission's core principle of competitive neutrality.

Moreover, as the Commission has previously recognized, universal service reform must provide equal support to all market participants within a high-cost area in order to be competitively neutral:

> A competitive eligible telecommunications carrier, when support is available, shall receive per-line high-cost support for lines that it captures from an incumbent LEC, as well as for any "new" lines that the competitive eligible telecommunications carrier serves in high-cost areas. **To ensure competitive neutrality, we believe that a competitor that wins a high-cost customer from**

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[4] *See, e.g.*, Federal-State Joint Board on Universal Service, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 11,244 (2001) at para. 25.
[5] 47 U.S.C. Section 254(b).

> **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.** While hold-harmless amounts do not necessarily reflect the forward- looking cost of serving customers in a particular area, we believe this concern is outweighed by the competitive harm that could be caused by providing unequal support amounts to incumbents and competitors. **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.** (emphasis added, footnote omitted).[6]

Presumably the auction "winner" will receive a franchise that entitles it to be the sole recipient of support for some substantial period of time, perhaps as long as ten years. If so, then any new carrier entering the market will have to be more efficient than the auction winner by the amount of subsidy the auction winner receives. That is the very definition of government-sponsored marketplace distortion and is precisely the problem the Congress intended to solve in the 1996 Act. Rather than picking a winner through an auction, *consumers* should pick the winner by exercising choice in the marketplace, without economic distortions imposed by the regulatory process.

In this vein, Cellular South rejects assertions that the universal service system should not subsidize competition in areas that will only support one carrier, for at least three reasons:

First, and most important, the statute on its face allows for designation of new ETCs in high-cost areas. The Commission has previously recognized that Congress could not have been more clear in its intent that universal service mechanisms be developed to work *with* competition, not stifle it:

> In the 1996 Act, Congress, recognizing that existing universal service support mechanisms were designed for a monopoly environment, directed the Commission to establish support mechanisms for the preservation and advancement of universal service ***in the competitive telecommunications environment that Congress envisioned.*** (emphasis added).[7]

By mandating competitive neutrality, the Commission has demonstrated an understanding that universal service reform must allow rural consumers to choose their service provider, just as urban consumers do.

Second, if taken to its logical conclusion, such statements mean that support should only be provided in areas where competition already exists. That cannot be right. In fact, support is intended for the highest-cost areas that are most in need of the benefits of new technologies.

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[6] Federal-State Joint Board on Universal Service, Ninth Report & Order and Eighteenth Order on Reconsideration, 14 FCC Rcd. 20,432, 20,480 (1999) ("Ninth R&O").
[7] Ninth R&O, 14 FCC Rcd. at 20,442.

Third, selecting a single winner in the nation's highest-cost rural areas would erect an artificial barrier to competitive entry, indefinitely locking consumers into whatever service the incumbent offers, while still being required to contribute to the system that denies them the benefits of choice. Moreover, failing to open rural markets to competition is a sure way to exacerbate our nation's recent descent among developing countries with respect to broadband penetration.

Verizon's suggestion that universal service should not support competition robs the consumer of the benefits of choice and ensures that universal service support will continue to subsidize inefficient legacy networks. This is a step backwards for the consumer. Congress intended for universal service to facilitate competition in areas that would not otherwise support competitive entry.

Under the 1996 Act, the acid test of whether any universal service reform proposal has merit is whether consumers benefit. ARCC's reform proposal would stabilize the fund, permit consumers to pick their technology of choice for voice communication services, and bring the benefits of competition to areas that do not have it today. The only beneficiaries under Verizon's plan are ILECs.

3. Verizon's Plan Improperly Caps Support for CETCs.

Verizon's plan caps overall funds at current levels, even though most CETCs have just begun to receive high-cost support and are in the early stages of building high-quality and efficient networks in high-cost areas to accommodate consumer demand for those services.[8] Without universal service support, these technologies would not today be accelerating at such a rate in rural and high-cost areas. It makes little sense to cap support to a growing newcomer because presumably the carrier will require additional support as its network grows to meet consumer demand in sparsely populated areas. Likewise, allowing support to remain level for wireline carriers makes little sense because as access lines decline, support levels remain artificially high, and in fact increase on a per-line basis.

Verizon's plan also ignores that ILECs faced no such caps on their support while their networks were being constructed. In other words, they received support, plus a reasonable return on investment *while networks were being constructed*. Cellular South urges the Commission to avoid the situation where newcomers have the same obligations as incumbents, but have support capped at some artificial level that is insufficient to permit them to fulfill their obligations. That is not competitively neutral.

Universal service support should be user-based. For every rural area, the Commission should determine an amount of support that is sufficient to provide consumers with the

[8] Moreover, rural consumers' ability to obtain lower prices and greater service quantity from wireless are constrained as a result of unreasonably high special access pricing in areas where there is no competition for such services.

supported services and make the same amount of per-line support available to all eligible carriers. That will effectively control fund growth and allow consumers to choose the service provider that best meets their needs for the supported services.

4. Verizon's Plan Provides No Assurance That Auctions Will Improve Affordability Without Regulation of Pricing.

Verizon's auction proposal confers an artificial advantage upon the auction winner and creates, at most, a duopoly with the ILEC. By definition, a duopoly does not encourage price competition or consumer benefit. An auction mechanism that chooses a single winner will not improve affordability because exclusive subsidies pose a barrier to new competition.

As a practical matter, if a single CETC is designated, and its bid turns out to be insufficient to provide high-quality services, it will have to raise rates to earn a return. Worse, it will be free to raise its rates to a point where its revenues and support are just below what its competitors can match. By effectively locking new competitors out of rural areas, there will be less incentive for an auction-winning ETC to lower prices or improve service quality.

A related issue is the fact that all auction participants will have every incentive to bid as low as possible to win the auction and then provide the minimum level of service needed to comply with their obligations. This could result in a need for significant regulatory oversight (and increased administrative costs) to ensure that low bidders do not provide poor service to consumers or obtain unwanted pricing power otherwise unavailable in a competitive marketplace.

In order to achieve the universal service objective of providing affordable services under those scenarios, the Commission might have to regulate rates, since 47 U.S.C. Section 332 prohibits states from doing so. This is anathema to the "pro-competitive, de-regulatory" purposes of the 1996 Act[9] and would be contrary to Congress's "general preference in favor of reliance on market forces rather than regulation."[10] All of these likely outcomes can be avoided by fostering competition.

Competition drives consumer benefit by reducing prices and increasing service quality – a principle the Commission has championed for every telecommunications service and one which must not be abandoned in high-cost rural areas.

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[9] Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 113.

[10] *Petition of N.Y. State Pub. Serv. Comm'n to Extend Rate Regulation, Report and Order*, 10 FCC Rcd 8187, 8190, para. 18 (1995).

5. Verizon's Plan Does Not Take Into Consideration the Administrative Difficulties in Determining Areas to Be Auctioned.

ILEC study areas and wire centers comprise unique boundaries that do not match any other traditional political or regulatory boundaries. For wireless, the FCC has licensed carriers on numerous geographic bases, including but not limited to, Major Trading Areas, Basic Trading Areas, Rand McNally Metropolitan Statistical Areas and Rural Service Areas. ESMR licensees are licensed on a different system. In short, defining the area to be auctioned is going to present immense complexity. Moreover, defining auctionable areas based on any one carrier's boundaries is not competitively neutral to other auction participants.

Compounding that complexity is the fact that, as of today, GSM and CDMA handsets are not interoperable. That is, a GSM handset does not work on a CDMA network, and vice-versa, even for 911 calling. Only a few ESMR handsets also work on CDMA. Thus, designating a single auction winner will provide rural consumers in an area with one technology. In rural areas, it is very likely that a GSM winner will sit side by side with a CDMA or ESMR winner in an adjacent area. Consumers moving around rural areas will find huge dead areas where, for example, their CDMA phone does not work in GSM territories, even for 911. Consumers who can't make or receive calls will be the losers.

ARCC's reform proposal permits competitors to enter wherever possible, minimizing regulatory distortions that harm consumers.

6. Verizon Is Mistaken That Competitors Today Do Not Have Proper Incentives.

Verizon claims that the current system does not provide proper incentives for competitors. Cellular South could scarcely disagree more. Today, support among CETCs is ***fully portable***, which is a much greater incentive to serve consumers and operate efficiently than the remit-and-collect system applicable to ILECs. Put simply, CETCs only get support when they get a customer, and they lose support when they lose a customer. As a result, every decision must be made with the goal of getting and keeping customers. There is no safety net to bail out consumer defections, nor is there a "revenue requirement" on which to base CETC support. Because of this system, CETCs already have every incentive to provide high-quality services at reasonable prices in order to attract and retain customers.

Furthermore, most states and the FCC require CETCs to report their investments to demonstrate that rural consumers are receiving the benefits that the system was intended to deliver. In Mississippi, Cellular South provides quarterly reports to the state commission on its investment activities. These reporting requirements demand a level of accountability for CETCs and ensure that universal service support is used in accordance with Congress' intent.

When it comes to incentives, Verizon has it exactly wrong. It is the ILECs who do not have proper incentives under the current system. ILECs receive guaranteed support based on stated revenue requirements and without regard to whether that ILEC is gaining or losing customers. ILEC investments are not sufficiently monitored in some areas. The current system for ILECs – which Verizon's proposal would perpetuate indefinitely for more than 90% of ILECs – does not encourage ILECs to provide high-quality service and does not demand accountability for their use of consumers' money. Verizon's proposal does nothing to change this inefficient system. Instead, Verizon would preserve this system and reward ILECs for continuing their inefficiencies.

The Commission must move toward a system where all market participants compete for support and for customers. That is the only way to deliver the benefits of universal service to consumers without distorting the marketplace or reducing carrier incentives to provide high-quality service.

7. Any Plan That Fails to Advance Both Universal Service and Competition in Rural Areas Must be Rejected.

The ARCC plan upholds both of the 1996 Act objectives: to advance universal service and to promote competition throughout the country. It provides the correct incentives to carriers and will promote affordable voice communication services by bringing competitive choices to rural America. And it can be done within the current mechanisms.

Verizon's plan, which (1) insulates ILECs from competition, (2) fails to provide *any* incentive for more than 90% of ILECs to become more efficient, and (3) robs rural consumers of the benefits of the rapid deployment of new technologies, must be rejected.

Cellular South encourages the FCC to continue to implement universal service reform as it did for over seven years after the 1996 Act. In the near term, the following three reforms will accomplish the reform objectives set forth in the 1996 Act and the FCC's rules:

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

- Portability: Rural ILECs Must Transition to a System that Makes Support "Fully Portable".

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

Wireless networks in rural areas need support to improve infrastructure and provide high-quality service. At a time when the United States is next to last in mobile wireless penetration in the industrialized world, any proposal that would significantly reduce support to wireless networks is fatally flawed.

Respectfully submitted,

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