

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

**REPLY COMMENTS OF UNITED STATES CELLULAR CORPORATION**

David A. LaFuria  
Steven M. Chernoff  
Lukas, Nace, Gutierrez & Sachs, Chartered  
1650 Tysons Boulevard, Suite 1500  
McLean, Virginia 22102  
(703) 584-8678

June 2, 2008

## TABLE OF CONTENTS

SUMMARY .....	i
I. INTRODUCTION. ....	2
II. THE RECORD SUPPORTS THE CONCLUSION THAT THE COMMISSION SHOULD NOT REPEAL THE IDENTICAL SUPPORT RULE, BUT INSTEAD SHOULD TAKE OTHER ACTIONS TO ENSURE THE SUFFICIENCY AND STABILITY OF THE HIGH-COST FUND. ....	6
A. Commenters Who Support Repeal of the Identical Support Rule Have Failed To Provide any Factual, Legal, or Public Policy Basis for Doing So.....	7
1. The Purported “Crisis” Faced by the High-Cost Fund Does Not Provide Sufficient Grounds for Repeal of the Identical Support Rule.....	8
a. Commenters Claiming that Competitive ETC Funding Is Responsible for Unsustainable Fund Growth Ignore Other Explanations for This Growth and Fail To Explain the Nature and Extent of the Purported Threat to the Fund’s Viability.....	9
b. The Lack of Portability of Incumbent LEC Support, Rather Than the Reasonable and Expected Growth in Competitive ETC Support, Is a Chief Cause of the Current Level of Fund Disbursements.....	14
c. Commenters Supporting Elimination of the Identical Support Rule Fail To Support Their Claim That Fund Growth Will Continue To Accelerate and Will Threaten the Sustainability of the Fund.....	17
d. Cutting Off IAS, ICLS, and LSS Support to Competitive ETCs Would Be Unsupportable.....	19
2. Proponents of Repeal of the Identical Support Rule Fail To Explain How Elimination of the Rule Would Be Consistent with Statutory Mandates and the Principle of Competitive Neutrality.....	23
a. Advocates of Eliminating the Identical Support Rule Are Incorrect in Their Contention That the Rule Is Not Competitively Neutral Because It Provides the Same Level of Support to Carriers with Differing Costs.....	23
b. Commenters Favoring Repeal of the Identical Support Rule Do Not Explain Why the Issue of Substitutability Between Wireline and Wireless Voice Services Supports Elimination of the Rule. ....	30
3. Supporters of the Commission’s Proposal To Repeal the Identical Support Rule Fail To Demonstrate That Public Policy Goals Compel Repeal of the Rule. ....	37

a.	The Identical Support Rule Promotes Efficient Investment by Wireless Competitive ETCs. ....	38
b.	The Record Does Not Support a Conclusion That the Identical Support Rule Inefficiently Promotes the Operation of Multiple Wireless Networks. ....	40
B.	The Commission Is Criticized by Many Commenters for Its Failure To Consider Other Alternatives To Ensure the Sufficiency and Sustainability of the High-Cost Fund, and the Efficient Use of Fund Resources.....	42
1.	The Commission Should Make Rural Incumbent LECs’ High-Cost Support Fully Portable.....	43
2.	The Commission Should Consider Other Measures To Reform Administration of High-Cost Funding Mechanisms.....	44
C.	Many Commenters Demonstrate That Imposing an Embedded Cost Methodology on Wireless Competitive ETCs Would Be a Bad Idea.....	45
1.	The Record Reflects Strong Opposition to Using the Embedded Cost Model as a Mechanism for Wireless Competitive ETCs’ High-Cost Funding. ....	45
2.	Imposing a Cost Accounting System on Wireless Competitive ETCs Based on Part 32 of the Commission’s Rules, or Based on Any Similar Cost Accounting Model, Would Be Burdensome and Unfair. ....	46
3.	It Would Be Implausible and Unfair To Determine Wireless Competitive ETCs’ Support Based on National Average Benchmarks Derived from Incumbent LECs’ Costs. ....	50
4.	The Record Reveals Glaring Problems Associated with the Commission’s Proposal To Cap Wireless Competitive ETCs’ Per-Line Support at the Level of Incumbent LECs’ Per-Line Support.....	51
5.	The Commission Should Reject the Proposal to Use Incumbent LEC Study Areas as a Basis for Determining Competitive ETCs’ Support Disbursements.....	53
III.	THE COMMISSION SHOULD REJECT PROPOSALS TO USE REVERSE AUCTION MECHANISMS TO DISBURSE HIGH-COST SUPPORT. ....	54
A.	The Many Problems Associated with Reverse Auctions Make Them Unsuitable as a Mechanism for Allocating High-Cost Support. ....	55
B.	The Commission Should Reject Single-Winner Auctions Because They Would Be Anti-Competitive, They Would Result in Intrusive Regulation, and They Would Cause Other Serious Problems.....	58
IV.	THERE IS STRONG SUPPORT IN THE RECORD FOR EXPANDING FUNDING FOR BROADBAND SERVICES BY INCLUDING BROADBAND AS A SUPPORTED SERVICE. ....	61
V.	CONCLUSION.....	63

## SUMMARY

### *The Identical Support Rule*

The Commission should reject the proposal to eliminate the identical support rule. The record does not support claims that the high-cost fund currently faces (or will face in the foreseeable future) a crisis of such severity that the drastic step of removing the identical support rule is warranted or justifiable. Not only have supporters of repeal of the rule failed to make the case that a funding crisis compels such an action, but they have also failed to account for factors other than competitive eligible telecommunications carrier (“ETC”) funding — such as the lack of portability of incumbent local exchange carrier (“LEC”) support — that have contributed significantly to the current overall level of high-cost funding.

The unreasonableness of the Commission’s proposal to eliminate the identical support rule is placed in particularly stark relief from the perspective of consumers. For a wireless consumer with a \$50 bill, the monthly universal service charge under the FCC’s “safe harbor” calculation is \$2.10. Of that amount, ninety-three cents (\$0.93) goes to support high-cost disbursements to incumbent LECs, while only thirty-five cents (\$0.35) is used to support competitive ETCs’ networks. (The balance goes to fund the schools and libraries, Lifeline/Linkup, and rural health care programs, and other administrative expenses incurred by the Universal Service Administrative Company.) For many consumers not subject to the “safe harbor”, the universal service charge is often much less.

These figures make it obvious that high-cost funding to competitive ETCs has a minimal impact on consumers, especially when compared to the consumer impact of funding incumbent carriers. The figures also raise the question of why the Commission has proposed no immediate steps to review high-cost disbursements to incumbents.

The record also fails to provide any convincing rationale to support a conclusion that elimination of the rule would be consistent with the Act and the principle of competitive neutrality. In particular, supporters of repeal have failed to lend any weight to the theory that a perceived lack of “complete” substitutability between wireline and wireless voice services excuses the Commission from enforcing its own “core principle” of competitive neutrality, adopted eleven years ago.

The record does, however, amply demonstrate that the identical support rule provides competitive ETCs with sufficient incentives to invest efficiently in networks and facilities in furtherance of universal service goals and policies, and that there is no basis for concluding that the rule somehow promotes the inefficient construction and operation of multiple networks by wireless competitive ETCs.

In addition, many commenters have urged the Commission, instead of repealing the identical support rule, to focus on other alternatives — such as pursuing comprehensive reform, including implementing full portability of incumbent LEC funding — to ensure the sufficiency and stability of the high-cost fund. These alternatives offer immediate and effective means for controlling high-cost fund growth, and also can be implemented by the Commission without compromising competitive neutrality.

With these Reply Comments, U.S. Cellular includes a white paper authored by David E. M. Sappington, Ph.D., a former FCC Chief Economist and currently the Lanzillotti-McKethan Eminent Scholar in the Department of Economics at the University of Florida, titled “*Universal Service Policy in the Competitive Telecommunications Era: The Advantages of Identical Support and The Disadvantages of Asymmetric Support*” (hereinafter the “Sappington Paper”). Dr. Sappington discusses the FCC’s original and underlying rationale for providing identical and porta-

ble support to the carrier that serves the customer. His work contrasts new proposals to provide asymmetric support based on costs of various carriers using different technologies. As detailed below and in the attached paper, Dr. Sappington concludes that portable and identical per-line support is the best means of providing universal service support to carriers operating in a competitive marketplace.

### ***Embedded Cost Regime for Wireless Carriers***

The Commission's proposal to eliminate the identical support rule brings with it the companion proposal to impose an embedded cost regime on competitive ETCs. Many commenters, however, strongly urge the agency not to take such a step. These commenters have pointed to the burdens and problems that would be generated by any attempt by the agency to impose cost accounting requirements on wireless competitive ETCs.

In particular, the record exposes the unfairness and unreasonableness of the Commission's proposal (as part of its proposed embedded cost regime for wireless competitive ETCs) to base wireless carriers' support on national benchmarks developed from *incumbent LECs'* costs. Such an approach, which would have the likely effect of systematically reducing the level of wireless carriers' support, makes little sense in light of the agency's tentative view that the identical support rule should be repealed because it bases wireless carriers' support on incumbent LECs' costs.

Even worse, according to several commenters, is the Commission's proposal to cap wireless competitive ETCs' per-line support at the level of *incumbent LECs'* per-line support. Given the Commission's proposal to eliminate the identical support rule in order to cut the link between wireless competitive ETCs' support and incumbent LECs' costs, how could it conceivably make

any sense to place a limitation on the level of wireless carriers' support that is based on the costs of incumbent LECs?

Worse still, many commenters argue, is the proposal to terminate Interstate Access Support ("IAS") and Interstate Common Line Support ("ICLS") funding currently available to wireless competitive ETCs, as well as the Commission's seeking comments on whether to eliminate Local Switching Support ("LSS") funding for competitive ETCs. The record presents convincing arguments that the Commission's proposal cannot be justified on the ground that wireless carriers should not receive this support because it replaces implicit subsidies that incumbent LECs (but not wireless carriers) formerly received through access revenues, or on the ground that IAS, ICLS, and LSS support is unnecessary for wireless carriers because they can recoup costs by raising their unregulated rates. The first argument reveals a misunderstanding of the differences between, and the different treatment of, implicit subsidies and explicit universal support. The second argument displays a misconception of the pricing options available to wireless carriers in competitive markets.

### ***Reverse Auctions***

Numerous commenters urge the Commission to reject the use of reverse auctions as a mechanism for disbursing high-cost support, demonstrating that competitive bidding would likely have unintended and harmful consequences for consumers in rural and other high-cost areas. The record identifies a number of hazards that would be posed by reverse auctions, including the risk that auctions could not be designed and administered in a competitively neutral manner, that service quality would be adversely affected, that auction participants failing to submit winning bids could be left with stranded investments, that auctions would not provide sufficient incen-

tives for investment in network build-outs, and that the ability of carriers to obtain sufficient financing could be compromised.

The record also supports U.S. Cellular's view that single-winner auctions should not be implemented by the Commission because they would have the anti-competitive effect of re-monopolizing the provision of service in rural and other high-cost areas. In addition to causing problems that are inherent in any reverse auction model (such as barriers to financing and the deterioration of service quality), commenters also demonstrate that single-winner auctions would require "hyper-regulation" to oversee the operations of the auction winner.

### ***Supporting Broadband Service***

U.S. Cellular suggested in its Comments that the Commission should include broadband in the definition of services supported by universal service support mechanisms. A number of commenters have supported this position, arguing that treating broadband as a supported service will provide incentives for further broadband deployment in rural and other high-cost areas.

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

**REPLY COMMENTS OF UNITED STATES CELLULAR CORPORATION**

United States Cellular Corporation (“U.S. Cellular”), by counsel, hereby provides these reply comments on the following Notices of Proposed Rulemaking adopted by the Commission regarding the high-cost universal service support program: (1) *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, *Notice of Proposed Rulemaking*, 23 FCC Rcd 1467 (2008) (“*Identical Support Rule NPRM*”); (2) *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, *Notice of Proposed Rulemaking*, 23 FCC Rcd 1495 (2008) (“*Reverse Auctions NPRM*”); and (3) *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, *Notice of Proposed Rulemaking*, 23 FCC Rcd 1531 (2008) (“*Joint Board Comprehensive Reform NPRM*”).<sup>1</sup>

---

<sup>1</sup> See *Comment Cycle Established for Commission’s Notices of Proposed Rulemaking Regarding the Identical Support Rule, the Use of Reverse Auctions to Set High-Cost Universal Service Support, and the Federal-State Joint Board on Universal Service’s Recommendations for Comprehensive Reform of High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, FCC Public Notice, DA 08-499 (rel. Mar. 4, 2008) (providing that comments are due April 3, 2008, and reply comments are due May 5, 2008, and indicating that “parties may file consolidated comments . . . in response to the three Notices”); *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, DA 08-674 (Wireline Comp. Bur., rel. Mar. 24, 2008) (revising the pleading cycle to provide that comments are due April 17, 2008, and

## I. INTRODUCTION.

U.S. Cellular welcomes the opportunity to provide its Reply Comments in this proceeding, in which the Commission is considering proposals seeking to reform the high-cost mechanisms used to support the provision of services in rural and other high-cost areas throughout the Nation. U.S. Cellular believes that the comments submitted in this proceeding illuminate actions the Commission should take, and should not take, as it pursues these important reforms. U.S. Cellular urges the Commission, guided by the record of this proceeding, to adopt rules and policies that will preserve and advance universal service, and will continue to ensure that competitive forces are promoted and relied upon to bring affordable services to rural consumers.

The record in this proceeding has confirmed that the Commission's proposals to reform the high-cost funding mechanism are deficient in numerous respects.

First, although the Commission has been quick to claim that the high-cost fund is in dire jeopardy, it has not come close to making its case. Commenters supporting the agency's view either accept it as an *a priori* truth or recite the same unconvincing assumptions and arguments that have been advanced by the Commission. The record reflects the fact that the high-cost fund is not facing the crisis that the Commission has attempted to portray. Thirty-five cents per month on the average customer's phone bill hardly qualifies as "explosive" growth or an "emergency" requiring a cap on competitive ETC funding, nor does it form the rationale for the type of reform proposed by the Commission in this proceeding.

Second, the Commission has sought to pin the blame for the purported crisis on wireless competitive ETCs. Supporters of the agency's proposals either parrot the Commission's arguments in their comments or simply claim that the asserted problems faced by the high-cost fund

---

reply comments are due May 19, 2008); *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, DA 08-1168 (Wireline Comp. Bur., rel. May 15, 2008) (further revising the pleading cycle to provide that reply comments are due June 2, 2008).

have been generated by wireless competitive ETCs, without going any further. The record does not back up the Commission's claims.

However, the record does support U.S. Cellular's view that funding to wireless competitive ETCs has not caused "explosive" growth in the high-cost fund. In fact, other factors such as the lack of funding portability play a major part in accounting for the size of the fund. Continued wireless competitive ETC funding will not destabilize or risk the collapse of the fund.

Third, a number of commenters support U.S. Cellular's view that the Commission's proposal to eliminate the identical support rule reveals a willingness by the agency to abandon the principle of competitive neutrality. Removal of the identical support rule would have the effect of taking competition out of the equation with regard to the disbursement of high-cost support and vitiate the statutory requirement that all support must be portable.

Fourth, there is support in the record for U.S. Cellular's assessment that the Commission's substitutability analysis (wherein the agency claims that the competitive neutrality principle does not, in fact, apply because wireless service is not a complete substitute for wireline service) is flawed and cannot serve as a basis for removing the identical support rule.

Fifth, a number of commenters have urged the Commission to refrain from eliminating the identical support rule and instead consider other actions to ensure the sufficiency of the high-cost fund in a manner that does not sacrifice the benefits made available to rural consumers by the competitive delivery of telecommunications services.

Sixth, many commenters oppose the Commission's plan to adopt an embedded cost methodology for wireless competitive ETCs, pointing out that this methodology would impose burdensome and unwarranted cost accounting and reporting requirements on wireless carriers.

Seventh, there is substantial opposition in the record to implementing any competitive bidding scheme for the disbursement of high-cost support, and numerous commenters have criticized the single-winner auction proposal in particular because it would re-monopolize high-cost support and force extensive regulatory oversight.

And, eighth, there is little in the record that contradicts U.S. Cellular's view that, when the Commission's proposals in this rulemaking are taken as a whole, they amount to a one-sided and inequitable attempt to change the rules of the game for high-cost support. The theme and the effect of the Commission's proposals would undercut the ability of wireless competitive ETCs to provide competitive services in rural areas:

- The purpose of the identical support rule is to promote competitive entry and the competitive delivery of services by ensuring that high-cost support is disbursed in a competitively neutral manner. Eliminating portability would deal a severe blow to competition that rural consumers have been waiting for since 1996.
- Imposing rate-of-return type cost accounting and reporting requirements on wireless competitive ETCs not only would be burdensome but also would risk failing to accurately capture all wireless competitive ETC costs entitled to reimbursement from the high-cost fund.
- Disbursing high-cost support to wireless competitive ETCs based on their own embedded costs — but then imposing a ceiling on those disbursements, set at the per-line level of support received by rural incumbent LECs — would unfairly disadvantage wireless competitive ETCs and ignore the principle of competitive neutrality.
- The proposal to compare wireless competitive ETCs' embedded costs against a national benchmark of *wireline* costs for purposes of determining the level of eligibility for wireless competitive ETC reimbursements would provide support to wireless based on wireline costs, the inverse problem that the FCC is purportedly attempting to solve in this proceeding.
- And the same is true regarding the proposal to use incumbent LECs' geographic units to measure wireless competitive ETCs' costs for purposes of disbursing support. Requiring wireless competitive ETCs to measure their costs based on wireline network configurations and geographic service areas would be inherently unfair and burdensome, and would make it virtually impossible for wireless competitive ETCs to recoup their actual costs.

- Cutting off Interstate Access Support (“IAS”), Interstate Common Line Support (“ICLS”), and Local Switching Support (“LSS”) funding to wireless competitive ETCs not only would violate statutory mandates regarding the availability of explicit universal service support to *all* ETCs, but would also further undermine the ability of wireless competitive ETCs to provide high-quality services mandated by Section 254 of the Act by dramatically cutting the funds available to wireless carriers — perhaps by as much as 50%.
- Establishing single-winner auctions as the mechanism for disbursing high-cost support, in addition to its many other problems, would almost by definition remove competition from the equation of high-cost funding and further erode the ability of wireless competitive ETCs to enter and compete in rural markets.

In examining the picture that emerges from these proposals, it is difficult to escape the conclusion that the Commission has tentatively decided to pursue a course that would result in clipping off one of the principal goals of the Telecommunications Act of 1996 (the “1996 Act”)<sup>2</sup> and reducing the level of support available to wireless competitive ETCs.<sup>3</sup> Competition would be severely impaired. Universal service would once again become the preserve of incumbents, who would no longer need to face the rigor and discipline of competitive forces in vying for universal service support. Moreover, the opportunity for rural consumers to obtain affordable services, which are comparable in price and quality to services available to urban consumers, would be placed in serious jeopardy.

---

<sup>2</sup> Pub. L. No. 104-104, 110 Stat. 56 (1996). The 1996 Act has three principal goals:

(1) opening the local exchange and exchange access markets to competitive entry; (2) promoting increased competition in telecommunications markets that are already open to competition, including the long distance services market; and (3) reforming our system of universal service so that universal service is preserved and advanced as the local exchange and exchange access markets move from monopoly to competition.

*Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Carriers*, CC Docket Nos. 96-98, 95-185, *First Report and Order*, 11 FCC Rcd 15499, 15505 (para. 3) (1996).

<sup>3</sup> See Alltel Comments at 28. (A chart of commenter names and short-form citations is included in the Appendix to these Reply Comments.)

**II. THE RECORD SUPPORTS THE CONCLUSION THAT THE COMMISSION SHOULD NOT REPEAL THE IDENTICAL SUPPORT RULE, BUT INSTEAD SHOULD TAKE OTHER ACTIONS TO ENSURE THE SUFFICIENCY AND STABILITY OF THE HIGH-COST FUND.**

The Commission has proposed to repeal the identical support rule, which provides that per-line support provided to incumbent LECs must be identical to and “portable” to competitive ETCs.<sup>4</sup> The record provides several reasons that should convince the Commission to abandon its proposal.

First, the record does not supply the Commission with a sufficient factual, legal, or public policy basis for terminating the rule. Second, the agency’s proposal to supplant the identical support rule with an embedded cost methodology, for use in disbursing high-cost support to competitive ETCs, has encountered strong criticism in the record. And, finally, several commenters have pointed to other means at the Commission’s disposal that would be more effective in securing a stable and sufficient high-cost fund while also avoiding the problems inherent in repealing the identical support rule. These reasons for rejecting the agency’s proposal to repeal the identical support rule are discussed in the following sections.

Before turning to this discussion, however, we note the Commission’s adoption of an interim cap on high-cost disbursements to competitive ETCs.<sup>5</sup> With a competitive ETC-only cap in place, the Commission cannot now maintain that there is an immediate need to eliminate the identical support rule. Indeed, to the extent there ever was identical support (and in fact support has never been “identical”) it was definitively severed in the *Interim Cap Order*.<sup>6</sup> Since the agency is convinced that the cap will “halt the rapid growth of high-cost support that threatens the sustainability of the universal service fund[,]” the Commission’s previously perceived need

---

<sup>4</sup> *Identical Support Rule NPRM*, 23 FCC Rcd at 1468 (para. 1).

<sup>5</sup> *See Interim Cap Order*.

<sup>6</sup> U.S. Cellular believes that, twelve years after the 1996 Act, there remains today implicit universal service support within wireline carrier rate structures. Thus, per-line support to competitive ETCs has never been “identical.”

for urgent action in dealing with the identical support rule has been dissipated by the mission now accomplished. Having “stem[med] the explosive growth of USF[,]” the agency is now free to “pursue[] comprehensive reform of the program.”<sup>7</sup>

U.S. Cellular urges the Commission to ensure that this pursuit is in fact comprehensive. The best way to do that is to review *all* the existing high-cost funding mechanisms — including those currently utilized to disburse high-cost funds to rural incumbent LECs — in search of a global and holistic solution that will have the best chance of rationalizing the high-cost funding mechanisms in a way that benefits consumers in rural and other high-cost areas (as well as all consumers who indirectly contribute to the support of the high-cost fund).

**A. Commenters Who Support Repeal of the Identical Support Rule Have Failed To Provide any Factual, Legal, or Public Policy Basis for Doing So.**

To demonstrate the reasonableness of its proposal to eliminate the identical support rule, the Commission must explain and support its claim that the high-cost fund has been placed in jeopardy by rapid and uncontrolled growth precipitated by disbursements to competitive ETCs. In addition, the Commission must have a sufficient basis for concluding that elimination of the rule would accord with the mandates and requirements of the Communications Act of 1934 (the “Act”),<sup>8</sup> as amended by the 1996 Act, and would also be consistent with the agency’s own policies regarding universal service and competition. And, finally, the Commission must show that other alternatives available to it, which would avoid the legal and public policy issues implicated by repeal of the identical support rule, should not be pursued because they would not be effective in addressing the perceived crisis faced by the high-cost fund.

The arguments and explanations provided by the Commission in the *Identical Support Rule NPRM* fall short of supplying a sufficient basis for its proposed termination of the identical

---

<sup>7</sup> FCC News, “FCC Takes Action To Cap High Cost Support under the Universal Service Fund,” May 1, 2008, at 1.

<sup>8</sup> 47 U.S.C. §§ 151 et seq.

support rule. And now the record in this proceeding has not come to the rescue of the Commission's proposal. Supporters of the Commission's views on fund growth have done virtually nothing to build a case that the high-cost fund, as a result of competitive ETC disbursements, is in the midst of an unprecedented crisis requiring further precipitous action eliminating identical support in order to avoid a calamity.

These supporters have also failed to make any credible case that elimination of the identical support rule would be consistent with statutory mandates concerning portability and the dictates of the Commission's competitive neutrality principle. Nor has there been any attempt by detractors of the identical support rule to examine other alternative measures that would address the sufficiency and viability of the high-cost fund but would spare competitive ETCs the inequities and competitive disadvantages inherent in repeal of the identical support rule.

**1. The Purported "Crisis" Faced by the High-Cost Fund Does Not Provide Sufficient Grounds for Repeal of the Identical Support Rule.**

U.S. Cellular demonstrated in its Comments that the Commission had not provided a sufficient basis for its proposal to eliminate the identical support rule because the agency had not provided any persuasive evidence that near-term growth in the high-cost fund is likely to occur at a rate that would make the fund unsustainable, or that continued funding of competitive ETCs based on the identical support rule would be a principal cause of unsustainable high-cost fund growth.<sup>9</sup> The demonstrations made by U.S. Cellular have been confirmed in the record.

The next section discusses the failure of commenters supporting the Commission's position to support claims that fund growth is making the fund unstable and unsustainable, or to account for various additional factors affecting the sufficiency of the fund and the level of disbursements from the fund. The following section examines one of these factors — the lack of

---

<sup>9</sup> U.S. Cellular Comments at 16-25.

portability of incumbent LECs' high-cost support — in greater detail. Finally, we demonstrate that commenters favoring elimination of the identical support rule have failed to support their claim that, if the rule is not repealed, the high-cost fund will experience “explosive” future growth that will make the fund unsustainable.

**a. Commenters Claiming that Competitive ETC Funding Is Responsible for Unsustainable Fund Growth Ignore Other Explanations for This Growth and Fail To Explain the Nature and Extent of the Purported Threat to the Fund’s Viability.**

Before addressing other comments, let’s look at the purported “crisis” through the consumer’s eyes. For a monthly wireless bill of \$50, a customer currently pays about \$2.10 as a universal service charge if the wireless “safe harbor” is applied.<sup>10</sup> ( $\$50 \times 37.5\% \times 11.3\%$  contribution factor = \$2.10.) For consumers not subject to the “safe harbor” calculation, the contribution amount is often significantly less.<sup>11</sup>

Where does the \$2.10 monthly charge go? Forty-five percent, or about ninety-three cents (\$0.93), funds high-cost support for incumbent LECs, to fund already constructed fixed wireline voice networks. (That figure is based on a total USF fund of about \$7 billion.) Only about thirty-five cents (\$0.35) goes to wireless carriers (because wireless carriers draw about 17% of total USF support),<sup>12</sup> to fund competitive networks which are still under construction across rural America. The remainder is used to fund the schools and libraries, Lifeline/Linkup, and rural health care programs, and other administrative expenses incurred by the Universal Service Administrative Company (“USAC”).

---

<sup>10</sup> According to CTIA’s latest Semi-Annual Wireless Industry Survey, the average local monthly bill for wireless consumers in 2007 was \$49.79. See [http://files.ctia.org/pdf/CTIA\\_Survey\\_Year\\_End\\_2007\\_Graphics.pdf](http://files.ctia.org/pdf/CTIA_Survey_Year_End_2007_Graphics.pdf).

<sup>11</sup> For example, undersigned counsel’s wireless bill is \$79 per month and the federal universal service charge thereon is only 81 cents.

<sup>12</sup> See USAC 2007 Annual Report at 45, 51, available at [http://www.usac.org/\\_res/documents/about/pdf/usac-annual-report-2007.pdf](http://www.usac.org/_res/documents/about/pdf/usac-annual-report-2007.pdf).

Based on USAC's most recently available data, IAS and ICLS funds to competitive carriers comprise roughly 50% of funding received by competitive ETCs, or about \$550 million.<sup>13</sup> Viewed through the eyes of a \$50 a month consumer, elimination of IAS and ICLS would reduce the monthly universal service charge by seventeen cents (\$0.17), or \$2.04 per year. The Commission proposes nothing that would reduce the consumer's annual contribution of \$11.16 to fund fixed wireline networks.

Several things appear obvious:

(1) Thirty-five cents per month on the average customer's phone bill hardly qualifies as "explosive" growth or an "emergency" requiring a cap on competitive ETC funding, nor does it form the rationale for the type of reform proposed by the Commission in this proceeding;

(2) the proposed IAS/ICLS reform, seventeen cents per month, will not provide even lower-income consumers with any measurable relief in their daily lives, indeed it amounts to half a gallon of milk *per year*. Yet every rural consumer who receives improved wireless service has the opportunity to save hundreds, even thousands of dollars per year from their phone bills by avoiding costly intra-LATA and inter-LATA toll charges commonly imposed by rural wireline carriers;

(3) cutting \$550 million (as would be the result of eliminating IAS and ICLS as the Commission has tentatively concluded should be done) out of wireless investment in rural America *will* have significant impact on the ability of wireless carriers to rapidly expand the construction of new network facilities in rural America. U.S. Cellular, for example, has promised the Illinois Commerce Commission 121 new cell sites in rural southern Illinois following its designa-

---

<sup>13</sup> In 2007, competitive ETCs received a combined \$551.3 million in IAS and ICLS, which is 48.5% of total competitive ETC support in 2007. See Universal Service Monitoring Report (December 2007) at Table 3.2, available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-279226A5.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-279226A5.pdf).

tion as an ETC. A 50% cut in support will naturally result in U.S. Cellular's revising its build plans downward by a corresponding amount; and

(4) the lack of any comprehensive examination of how the ninety-three cents per month that consumers pay to wireline carriers is invested is unfair to consumers who pay into the fund. Wireless consumers now contribute roughly 40% of the total universal service fund, but receive benefits amounting to only 17% of the total. The inequity of wireless consumers paying into the fund out of all proportion to the benefits that they receive is so palpable that perhaps it is time for the Commission to consider the merits of creating separate funding pools — one funded by wireless customers for the benefit of wireless customers and another funded by wireline customers for the benefit of wireline customers.

Commenters who support termination of the identical support rule have presented virtually no evidence or arguments that contradict the arguments made and conclusions reached in U.S. Cellular's Comments regarding the causes of the size and growth of the high-cost fund, and the nature and extent of the purported crisis currently faced by the fund. Most of these commenters content themselves with parroting the paper-thin analysis presented by the Commission in the *Identical Support Rule NPRM*.<sup>14</sup>

Embarq, for example, argues that high-cost fund growth is a uniquely wireless phenomenon, but supports this view merely by citing the Commission's figures regarding fund growth from 2001 through 2006, and projections of fund growth for 2007.<sup>15</sup> Similarly, MSTCG expresses concern about the ballooning high-cost fund, but its analysis of the causes of this growth goes no further than pointing to the Commission's figures.<sup>16</sup> USTA claims that the method for

---

<sup>14</sup> See *Identical Support Rule NPRM*, 23 FCC Rcd at 1469 (para. 4).

<sup>15</sup> Embarq Comments at 15.

<sup>16</sup> MSTCG Comments at 5.

distributing high-cost funds is broken, but then simply quotes the numbers offered by the Commission in the *Identical Support Rule NPRM*.<sup>17</sup>

There are problems with the arguments made by these commenters. They do not provide any data explaining the nature and extent of the threat posed to the high-cost fund by recent growth in fund disbursements. The real issue here is whether recent growth has in fact posed a clear and present danger to the sustainability of the fund.

The Commission and commenters supporting its proposal presume that such a danger exists, forcing the need for immediate and drastic action to stabilize the fund. But neither the Commission nor these commenters present any measurements or metrics that could illuminate the continuum along which the fund passes from stability to instability, or that could provide some credible support for their assumptions about the crisis currently faced by the fund.<sup>18</sup> U.S. Cellular has suggested that it is not sufficient to rely upon these assumptions, especially in light of the drastic and precipitous “remedy” the Commission has proposed. U.S. Cellular further has examined one reasonable measurement for evaluating the risks posed by fund growth, *i.e.*, the potential impact of this growth on general consumer welfare, and has suggested that the growth of the fund is not posing significant adverse impacts on consumer welfare.<sup>19</sup>

---

<sup>17</sup> USTA Comments at 10-11. *See, e.g.*, Alexicon Comments on *Identical Support Rule NPRM* at 2; CenturyTel Comments at 7, n. 17; CoBank Comments at 3 (arguing, without further elaboration, that “[a] major source of growth in the USF high-cost program funding is centered on ETC support, which is not based on actual costs”); ITA Comments on *Identical Support Rule NPRM* at 2; ITTA Comments at 33; NCLC Comments at 3 (citing Testimony of Billy Jack Gregg, Director, Consumer Advocate Division, Public Service Commission of West Virginia, Senate Commerce, Science and Transportation Committee, Subcommittee on Communications, Mar. 1, 2007, at 4); New Jersey DRC Comments at 61; NTCA Comments at 20 (pointing to growth in competitive ETC funding from 2003 through 2007); Oklahoma CC Comments at 8-9; OPASTCO Comments at 10-11 (citing increases in competitive ETC projected disbursements from the second quarter of 2005 through the second quarter of 2008); RTA Comments at 5; Windstream Comments at 19; WTA Comments at 23; WYOCA Comments on *Joint Board Comprehensive Reform NPRM* at 2 (stating, but not explaining, that recent fund growth is “appropriately associated” with growth in competitive ETC funding “through the application of the identical support rule”).

<sup>18</sup> *See* URTA Comments at 4, n. 8 (noting that “[t]here is no finding or analysis determining at what level the universal service contribution becomes a burden . . .”).

<sup>19</sup> U.S. Cellular Comments at 18-20.

The second problem is that commenters arguing for repeal of the identical support rule have not supported the Commission's assumption that increased support to wireless competitive ETCs is a direct and exclusive cause of the perceived crisis that currently threatens the fund. These commenters embrace the Commission's attempt to connect these dots: recent fund disbursements to wireless competitive ETCs have increased; this has increased the overall size of the high-cost fund; this increase in size has destabilized the fund; therefore, wireless competitive ETCs — and the identical support rule that governs their fund disbursements — are the root cause of “explosive growth” that has placed the fund in crisis.

If the Commission wishes to deflect criticism that its evaluation of the causes of, and risks posed by, the growth of the fund is a result-driven attempt to establish a basis for terminating the identical support rule, then it is incumbent on the agency to take a less myopic view of the current and future state of the fund. For example, U.S. Cellular indicated in its Comments that recent increases in wireless competitive ETC high-cost fund disbursements are properly explained by the fact that, as recent competitive entrants, wireless carriers started from a base of zero high-cost fund support. As these carriers built out their networks and expanded the range of their service offerings in the years immediately following their market entry, there logically would be steep initial climbs in the level of their support.<sup>20</sup>

U.S. Cellular also indicated that high-cost fund support to wireless competitive ETCs actually has grown at an unremarkable rate that has simply mirrored the growth in demand for wireless services. Although it is true that annual high-cost support for wireless competitive ETCs has increased to about \$1.2 billion, it is also true that the number of wireless subscribers has increased from 118.4 million in June 2001 to more than 238.2 million in June 2007. Between June

---

<sup>20</sup> *Id.* at 20-21. See Chinook Comments at 2-4. (Chinook's comments were originally filed with the Commission as a letter submitted on February 22, 2008.)

2001 and June 2007, the average number of minutes that subscribers use their mobile devices each month rose from 320 to 746 minutes, or more than 12 hours per month. This staggering growth in wireless services, which reflects growing demand for wireless services in rural and other high-cost areas as well as across the Nation as a whole, presents a benign explanation for increased funding disbursements to wireless competitive ETCs that dampens the alarm bells being sounded by the Commission and commenters supporting termination of the identical support rule.<sup>21</sup>

Further, Cellular South indicates that, if the Universal Service Fund (“USF”) contribution factor is taken as a barometer of the rate of growth of the high-cost fund, then concerns about the fund’s recent “explosive” growth<sup>22</sup> are misplaced because the contribution factor was near its three-year low as recently as the first quarter of this year.<sup>23</sup>

Finally, Sprint Nextel observes that the viability of the high-cost fund is also affected by the size and stability of the contribution base, and, while the wireline carrier contribution base has been eroding in recent years, contributions from wireless carriers have increased from \$10 billion in 2001 to \$26 billion in 2006. Sprint Nextel notes that USF contributions from wireless carriers have far outpaced disbursements they receive from the high-cost fund.<sup>24</sup>

**b. The Lack of Portability of Incumbent LEC Support, Rather Than the Reasonable and Expected Growth in Competitive ETC Support, Is a Chief Cause of the Current Level of Fund Disbursements**

Any analysis of the factors accounting for the size of the high-cost fund, and of trends in the growth of the fund, cannot overlook the critically important role played by the Commission’s

---

<sup>21</sup> U.S. Cellular Comments at 21-22.

<sup>22</sup> *E.g.*, *Interim Cap Order* at para. 1.

<sup>23</sup> Cellular South Comments at 2. U.S. Cellular has explained that the increase in the contribution factor for the second quarter of 2008 is not reflective of any precipitous increase in wireless competitive ETC high-cost fund disbursements. *See* U.S. Cellular Comments at 18, n. 37.

<sup>24</sup> Sprint Nextel Comments at 8-9.

decision not to impose full portability on incumbent LEC fund disbursements.<sup>25</sup> Alltel, for example, points out that, although incumbent LEC high-cost funding in the aggregate has been roughly static over the last five years, major incumbent LECs' access lines have dropped by approximately 25 percent from 2001 to 2007. But this drop in access lines has had no impact on incumbent LECs' total draw from the high-cost fund.<sup>26</sup>

Both Alltel and Chinook explain that the flow of funding to incumbent LECs has remained the same even as they have been losing access lines because of the Commission's neglecting to finally end the transition period before portability<sup>27</sup> applies to rural incumbent LECs.<sup>28</sup> Chinook observes that this absence of portability is "a true and significant cause of fund growth."<sup>29</sup>

Centennial properly notes that the problem is with the lack of portability, not the identical support rule. "The key problem arises because of the current system's approach to *ILEC costs*. Today when an ILEC receiving high-cost support loses lines — including direct losses to wireless competitors — the system does not show a corresponding reduction in ILEC costs."<sup>30</sup> Centennial explains that, under the current system, "the assumption is that ILEC costs are not re-

---

<sup>25</sup> See *Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 96-45, CC Docket No. 00-256, *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256*, 16 FCC Rcd 11244, 11294-98 (paras. 123-131) (2001).

<sup>26</sup> Alltel Comments at 26.

<sup>27</sup> Portability involves per-line high-cost funding following the customer, so that, if a customer moves from one carrier to another, the former carrier loses high-cost funding.

<sup>28</sup> Alltel Comments at 26-27; Chinook Comments at 4-5.

<sup>29</sup> Chinook Comments at 5, n. 12. NCTA also has described how the lack of portability results in upward pressure on the high-cost fund, and has pointed out that the Joint Board actually has acknowledged that the existing funding mechanisms may not appropriately adjust support to reflect line losses due to competition. NCTA further argues that increased per-line support (due to the lack of portability) also spurs additional market entry, leading to a cycle of increased upward pressure on the fund. NCTA Comments at 7-8. See also T-Mobile Comments at 10-11 (citing the pressures on the fund created by the lack of portability, and also observing that competitive ETCs, unlike incumbents, do not retain high-cost fund support if they lose customers to competitors).

<sup>30</sup> Centennial Comments at 6 (emphasis in original).

duced, so that, in calculating the per-line support available to CETCs, the same amount of ILEC cost is spread over fewer lines. This results in a high per-line ILEC cost, which translates into a higher ‘equal support’ payment to the CETC.”<sup>31</sup>

The lack of portability has an extraordinary, ongoing impact on the size of the high-cost fund. U.S. Cellular has analyzed various data released by the Commission and the Federal-State Joint Board on Universal Service that demonstrate this impact, showing how the size of the fund would have been reduced if full portability of incumbent LECs’ support had been in effect beginning in 2002. If the Commission had enforced full portability, and incumbent LEC support had declined at the same rate as the actual decline in incum-

bent LECs’ access lines, then, as the accompanying Table shows, total savings in high-cost support from 2002 through 2007 would have exceeded \$5 billion, averaging nearly \$900 million per year.<sup>32</sup> The total amount of support disbursed to competitive ETCs during the same period was ap-

<b>EXCESS ILEC SUPPORT DUE TO LACK OF PORTABILITY</b>	
<b>YEAR</b>	<b>AMOUNT</b>
2002	\$423,600,000
2003	\$803,700,000
2004	\$972,200,000
2005	\$1,050,600,000
2006	\$1,020,600,000
2007	\$1,107,900,000
Total	5,378,600,000

proximately \$3.2 billion. The charts in Exhibit 1 further illustrate the impact that the lack of portability has had on the high-cost fund.

<sup>31</sup> *Id.* Centennial criticizes the current mechanism by noting that “common sense dictates that a provider who loses customers and provides less service should receive less support, while a provider that gains customers and provides more service should receive more.” *Id.* at 8.

<sup>32</sup> From June 2001 to June 2007, incumbent LEC switched access lines declined from roughly 175 million to roughly 134 million, an overall drop of approximately 24 percent. See *Local Telephone Competition: Status as of June 30, 2007*, at Table 1 (End-User Switched Access Lines Reported). Meanwhile, from 2001 to 2007, incumbent LEC annual high-cost support went up from approximately \$2.57 billion to approximately \$3.15 billion, an overall increase of approximately 22.5 percent. The total savings that would have resulted from full portability were calculated by determining the amount by which nationwide incumbent LEC high-cost support in a given year exceeded the support incumbent LECs would have received if it had declined at the same rate as nationwide incumbent LEC switched access lines. The first year for which this calculation was performed was 2002, using 2001 as the base data period. The savings for each year were then added together for an aggregate total.

**c. Commenters Supporting Elimination of the Identical Support Rule Fail To Support Their Claim That Fund Growth Will Continue To Accelerate and Will Threaten the Sustainability of the Fund.**

Having failed to demonstrate that recent growth in support levels has placed the high-cost fund in serious jeopardy or that wireless competitive ETCs should be blamed for the purported instability of the fund, commenters supporting elimination of the identical support rule turn to the issue of the future risks faced by the fund, and again fail to present any persuasive arguments or evidence that the fund is threatened by ongoing “explosive” growth that warrants the immediate (and one-sided) action proposed by the Commission. Most of these commenters, after citing recent fund growth attributable to wireless competitive ETC disbursements, simply assume implicitly that these growth rates will continue unabated, making the fund unsustainable.

The Florida PSC, for example, contends that “[t]he continued escalation of the size of the fund threatens the affordability that the program was intended to safeguard[.]” but does not provide any analysis or explanation of its assumption that current rates of growth will continue.<sup>33</sup> USTA follows the same pattern, arguing that “[u]nconstrained growth of the fund will increase the level of contributions to an unsustainable level” but failing to provide any evidence that such growth is likely to continue in the near-term future.<sup>34</sup>

Windstream claims that, in the absence of regulatory action, the annual growth trend in competitive ETC funding “is expected to continue” but provides no explanation of the basis for

---

<sup>33</sup> Florida PSC Comments at 8. *See also* URTA Comments at 7.

<sup>34</sup> USTA Comments at 6-7. USTA reassures the Commission that the agency’s reform measures can control fund growth so long as the Commission ignores “self serving calls for support to multiple competitors or for preservation of retail rates at levels significantly below a level that is considered affordable[.]” but then USTA manages to suspend its concerns about upward pressures on the size of the high-cost fund long enough to suggest that the Commission should guarantee that incumbent LECs are not harmed by intercarrier compensation reform. USTA indicates that the Commission can achieve this result by adopting the Missoula Plan, which would use the USF to generate “replacement funds” to offset incumbent LECs’ loss of access revenues. USTA assures the Commission that the savings generated by eliminating unnecessary high-cost funding currently provided to wireless competitive ETCs would make possible this intercarrier compensation “reform,” along with the increased USF support for incumbent LECs. *Id.* at 8-9.

this expectation.<sup>35</sup> On the other hand, some commenters are sufficiently confident that the high-cost fund does not face any serious peril from continuing growth that they oppose any overall cap on total high-cost funding and suggest that the need for broadband deployment in rural areas supports significant additional growth in universal service funding.<sup>36</sup>

Neither the Commission nor commenters supporting repeal of the identical support rule have constructed even a plausible foundation for their claim that removal of the rule is necessary to fend off the imminent collapse of the high-cost fund. Merely citing recent increases in wireless competitive ETC funding, without undertaking a more expansive examination of the factors that have contributed to the present size of the fund as well as its growth, does not provide a credible basis to conclude that blame for the purported fund crisis must be placed on wireless carriers.

Moreover, as U.S. Cellular explained in its Comments, there is no basis for the Commission to conclude that the initial historical growth in competitive ETC support will continue indefinitely at the same rate in future years, and, without such a showing, the agency cannot reasonably conclude that elimination of the identical support rule is necessary to “save” the high-cost fund. Indeed, the Commission ignored the precipitous drop in the fund’s rate of growth.<sup>37</sup> Cen-

---

<sup>35</sup> Windstream Comments at 19.

<sup>36</sup> See, e.g., WTA Comments at 27-28. WTA says that it understands that universal service support cannot grow indefinitely, but it argues that policymakers “need to recognize that the construction and upgrading of broadband infrastructure in rural areas is going to be very expensive and will require significant increases in high-cost support.” *Id.* at 26. WTA is concerned that an overall cap would “guarantee[] that the rural ILECs will be subjected to substantial and virtually automatic reductions in their high-cost support.” *Id.* At 28. See also New Jersey DRC Comments at 34 (arguing that “\$300 million [the initial annual broadband funding level recommended by the Joint Board] is far from adequate to extend deployment for the entire country”); Windstream Comments at 13 (arguing that “[t]he Broadband Fund, as currently proposed, cannot satisfy the public’s desire for ubiquitous broadband availability” and explaining that Windstream itself would need more than \$300 million to complete its deployment of broadband).

<sup>37</sup> U.S. Cellular Comments at 22-24. The Commission indicated in the *Interim Cap Order* that funding to competitive ETCs had increased at an annual growth rate of over 100 percent from 2001 through 2007, and then balefully concluded “that the continued growth of the fund *at this rate* is not sustainable and would require excessive (and ever growing) contributions from consumers to pay for this fund growth.” *Interim Cap Order* at para. 6 (footnote omitted) (emphasis added). The rest of the story, however, is that, as U.S. Cellular indicated in its Comments, the annual rate of growth in competitive ETC funding has declined from 181 percent between 2002 and 2003 to 20 percent between 2006 and 2007. U.S. Cellular Comments at 23. A more pertinent analysis for the Commission would

ennial points out that, even assuming that high-cost fund support growth has been driven by the rising level of wireless subscribers in recent years, this rapid subscribership growth cannot continue,<sup>38</sup> and, therefore “growth of the fund driven by pure subscribership growth will, necessarily, slow down in the near future.”<sup>39</sup> Even if the wireless portion of the fund were to double to \$2.4 billion a year, the incremental cost to the typical wireless customer would be an additional thirty-five cents per month, or \$4.20 a year, or about the cost of a gallon of gas.

**d. Cutting Off IAS, ICLS, and LSS Support to Competitive ETCs Would Be Unsupportable.**

With respect to IAS and ICLS support, commenters favoring elimination of the provision of this support to wireless competitive ETCs make two main arguments. First, they contend that wireless carriers should not receive such support because the support is intended to replace implicit subsidies that incumbent LECs formerly received through access revenues, and, since wireless carriers never received access revenues, they should not be entitled to the “replacement” IAS and ICLS support.<sup>40</sup> And, second, these supporters argue that IAS and ICLS support is unnecessary for wireless carriers because they can recover their costs through their unregulated rates.<sup>41</sup> Neither of these arguments is persuasive.

U.S. Cellular agrees with CTIA’s assessment that the Commission’s proposal to cut off IAS and ICLS funding to wireless carriers, because the funding represents “access revenue re-

---

be to determine whether overall fund growth would be unsustainable if the rate of growth in funding to competitive ETCs were to continue to decline year-to-year by the same percentage trends that have occurred between 2002 and 2007.

<sup>38</sup> There were approximately 242 million wireless subscribers at the end of 2006, compared to a total U.S. population of 300 million. Centennial Comments at 8.

<sup>39</sup> *Id.*

<sup>40</sup> See Alexicon Comments on *Identical Support Rule NPRM* at 5; ATA Comments at 7; CenturyTel Comments at 23; Embarq Comments at 12; ITA Comments on *Identical Support Rule NPRM* at 4; ITTA Comments at 29-30; JSI Comments at 3; NASUCA Comments on *Identical Support Rule NPRM* at 8; NTCA Comments at 23; Qwest Comments at 7 & n. 20; RTA Comments at 7; Verizon Comments at 38; Windstream Comments at 23.

<sup>41</sup> See CenturyTel Comments at 23; Florida PSC Comments at 3-4; MSTCG Comments at 7-8; RTA Comments at 7; TCA Comments at 15; USTA Comments at 12-13; Windstream Comments at 23.

placement,” attempts to have it both ways. If IAS and ICLS are merely “access replacement,” then they cannot be funded at all through universal service mechanisms. If, however, IAS and ICLS constitute explicit universal service support, then by law it must be portable and all ETCs — not just incumbent LECs — are entitled to the support.<sup>42</sup>

Alltel elaborates on CTIA’s point by noting that, since the Commission has already explained that its purpose in establishing the IAS and ICLS funds was to turn implicit subsidies into explicit universal service support,<sup>43</sup> the agency now “cannot force the genie back into the bottle by turning these explicit support funds back into monopoly-only implicit subsidies.”<sup>44</sup> Commenters supporting the Commission’s proposal do not — and cannot — explain how the agency could eliminate the provision of IAS and ICLS support to a class of ETCs after the Commission has determined that this support must be fully portable among all classes of ETCs and after the *Alenco* court<sup>45</sup> has confirmed that the statute compels portability.

---

<sup>42</sup> CTIA Comments at 18. *See* Alliance of Rural CMRS Carriers, Alltel, Centennial Communications Corp., Dobson Cellular Systems, Inc., CTIA, Written Ex Parte Presentation, CC Docket No. 96-45, CC Docket No. 01-92, Oct. 9, 2006, at 2:

If the revenue [from IAS and ICLS support] represents universal service support and is funded by universal service contributions, it must be portable. Conversely, if it is not universal service, then there is no justification for providing the guaranteed revenue stream to the ILECs (or any other class of carrier), and these funds should be eliminated altogether.

*Cf.* Centennial Comments at 3-4 (“Giving subsidies to one provider without offering them to competitors is nothing more or less than institutionalized predatory pricing. . . . [U]nless we are prepared to relegate rural American communities to the status of permanent monopolistic backwaters, support available to one vendor must be available to all.”) (footnote omitted).

<sup>43</sup> Alltel Comments at 37 (citing *Identical Support Rule NPRM*, 23 FCC Rcd at 1477 (para. 23)). The *Identical Support Rule NPRM*, in explaining the origins of the IAS and ICLS support mechanisms, cites *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45*, 15 FCC Rcd 12962, 12975-76 (paras. 31-32 (2000) (“*CALLS Order*”), *aff’d in part, Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001)). *See Identical Support Rule NPRM*, 23 FCC Rcd at 1477 (para. 23, n. 55). The *CALLS Order* indicates that the proposal adopted by the Commission replaced the access “subsidies with explicit interstate access universal service support [that is] *fully portable* among eligible telecommunications carriers.” *Id.* at 12975-76 (para. 32) (footnote omitted) (emphasis added).

<sup>44</sup> Alltel Comments at 37.

<sup>45</sup> *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 616 (5th Cir. 2000) (“*Alenco*”).

GCI also exposes the flaws in the Commission’s claim that competitive ETCs are not entitled to access “replacement” support, arguing that “there is no relationship between whether a carrier historically charged a carrier common line charge and whether the carrier today has costs that need to be recovered from universal service support in order to preserve affordable and reasonable comparable services and rates.”<sup>46</sup>

Regarding the second argument advanced by supporters of the Commission’s proposal, to suggest that wireless competitive ETCs should not receive IAS or ICLS support because they can recover revenues lost through elimination of the support by increasing rates to their customers, is to pretend (or wish) that the Act does not require the promotion of competition in rural and other high-cost areas. Alltel captures the surreal nature of this proposal by pointing out that it:

would enshrine the outrageous notion that ILECs should be guaranteed significant advantages in the marketplace and left alone in their enjoyment of certain categories of support, because competitive carriers can always just charge higher rates to their subscribers — meaning the very consumers that should reap the benefits of competition in the form of reduced prices and improved services.<sup>47</sup>

GCI takes a similarly dim view of the Commission’s rationale, contending that “[t]his ‘analysis’ can only charitably be referred to as ‘Alice in Wonderland’ economics, with no grounding in or citation to known principles of microeconomics. This ‘analysis’ and related tentative conclusions should be rejected.”<sup>48</sup>

---

<sup>46</sup> GCI Comments at 49. GCI also explains that barring competitive ETCs from the continued receipt of ICLS support would violate competitive neutrality. *Id.* at 50-51.

<sup>47</sup> *Id.* at 39 (footnote omitted). *See* T-Mobile Comments at 7 (the assumption that competitive ETCs have more discretion than incumbent LECs to charge their end users and therefore do not “need” IAS, ICLS, or LSS misses the mark; “[t]hose high-cost funds are justified by — and, according to the Commission, are needed to cover — the cost of serving high-cost *customers*, irrespective of which *carrier* provides the service.”) (emphasis in original).

<sup>48</sup> GCI Comments at 43. GCI demonstrates that the principal fault with the Commission’s analysis is that, if incumbent LECs continue to receive ICLS support to help recoup their interstate common line costs, “it doesn’t take an advanced degree in economics to recognize that . . . the CETC will not be able to sell the same product to the same customer” for a higher rate. *Id.* at 44. “Certainly the Commission has cited no evidence that a CETC faces inelastic firm-specific demand curves when competing with the ILEC. More realistically, the CETC will be limited to charging what the ILEC can charge . . .” *Id.* GCI also observes that the Commission has previously acknowledged this limitation on competitive ETC pricing. *Id.* at 45 & n. 80 (citing *Western Wireless Corporation Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Com-*

U.S. Cellular therefore renews its request that the Commission reject the proposal to eliminate IAS and ICLS funding for competitive ETCs and continue to treat this support as fully portable, consistent with the Act and the agency's own rationale that portability is necessary to comply with the principle of competitive neutrality.<sup>49</sup>

In addition, the Commission sought comment on whether LSS support also should be eliminated for competitive ETCs.<sup>50</sup> Some commenters who support elimination of LSS support contend that it is inappropriate for competitive ETCs to continue receiving this support because LSS makes assumptions about the nature of switching costs that are not likely to be accurate with regard to competitive ETCs' costs,<sup>51</sup> and because continuing to extend LSS support to competitive ETCs is inconsistent with the manner in which these carriers recover their costs.<sup>52</sup>

The problems associated with eliminating LSS funding for competitive LECs are essentially the same as those involved with any elimination of IAS and ICLS funding. Permitting incumbent LECs to continue to receive LSS funding, but withdrawing such funding from competitive ETCs, would violate the principle of competitive neutrality because the incumbent LECs would be able to use the subsidy to fund their competitive services, and thus gain an advantage

---

*munications Act of 1934, Memorandum Opinion and Order*, 15 FCC Rcd 16227, 16231 (para. 8) (2000)). See also RICA Comments at 18; ST & MT Comments at 11. In addition to commenters such as GCI who have rebutted the arguments advanced by supporters of the Commission's proposal regarding IAS, ICLS, and LSS funding, opponents of the proposal have provided additional reasons for rejecting the Commission's approach. ATN, for example, argues that the proposal would provide discriminatory protection to incumbent LECs and also would be anti-competitive because incumbent LECs would be able to fund their competitive services through revenues from their IAS, ICLS, and LSS subsidies. ATN Comments at 16-17.

<sup>49</sup> U.S. Cellular Comments at 54 (citing *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service*, CC Docket No. 00-256, CC Docket No. 96-45, *Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166*, 16 FCC Rcd 19613, 19678 (para. 151) (2001)).

<sup>50</sup> *Identical Support Rule NPRM*, 23 FCC Rcd at 1477 (para. 24).

<sup>51</sup> Florida PSC Comments at 3-4. Indeed, a careful analysis of how LSS is calculated would likely reveal that the mechanism fails to accurately reflect how wireline switching costs are caused, another reason why reform must truly be "comprehensive."

<sup>52</sup> MSTCG Comments at 7-8.

over competitive entrants. In U.S. Cellular’s view, there is no rational policy basis for providing such discriminatory protection to incumbent LECs. As Alltel points out, eliminating LSS (as well as IAS and ICLS) would reduce the availability of wireless service in rural areas while doing nothing to spur the investment in critically needed mobility and broadband infrastructure.<sup>53</sup>

**2. Proponents of Repeal of the Identical Support Rule Fail To Explain How Elimination of the Rule Would Be Consistent with Statutory Mandates and the Principle of Competitive Neutrality.**

Many commenters who favor the Commission’s proposal to terminate the identical support rule do not attempt to explain how such an action would be consistent with the 1996 Act or the Commission’s policies. Supporters of the Commission’s proposal who do address these issues rely principally on two lines of argument. First, without explaining why the FCC’s repeated pronouncements that identical support is competitively neutral are flawed, they contend that the identical support rule is not competitively neutral. Most do not even attempt to address the issue of portability. And, second, these commenters endorse the Commission’s view that wireless services are not a “complete substitute” for wireline voice services, leading to their conclusion that elimination of the identical support rule need not be reconciled with the competitive neutrality principle. Neither of these arguments is persuasive.

**a. Advocates of Eliminating the Identical Support Rule Are Incorrect in Their Contention That the Rule Is Not Competitively Neutral Because It Provides the Same Level of Support to Carriers with Differing Costs.**

CenturyTel argues that “[t]he identical support rule is not ‘competitively neutral’ . . . . Rather, it simply gives each carrier the same amount of money, regardless of their differing costs.”<sup>54</sup> Similarly, RICA contends that “[t]he neutrality principle is violated . . . when carriers

---

<sup>53</sup> Alltel Comments at 22.

<sup>54</sup> CenturyTel Comments at 22. *See also* Indiana URC Comments at 9-10 (arguing that the identical support rule does not account for the “unique characteristics of a carrier’s own costs” and gives an unfair advantage to competi-

with materially different cost structures are treated as if they had identical cost structures.”<sup>55</sup> In fact, the identical support rule *is* competitively neutral precisely because neither incumbents nor competitive ETCs are unfairly advantaged or disadvantaged by high-cost disbursements. Identical *and portable* support ensures that the high-cost fund does not put a thumb on the competitive scale.<sup>56</sup>

As U.S. Cellular explained in its Comments, the key to the identical support rule is that the *level* of support (regardless of whether support is calculated based on an incumbent LEC’s costs or on some other basis) must be the same for both incumbents and competitive ETCs, and must be fully portable in order to minimize market distortions.<sup>57</sup> As Dr. Sappington explains:

The Commission followed standard, widely-accepted principles when it instituted portable, identical support. Such support is essential to ensure a level playing field and competitive neutrality. If different levels of support were provided to different suppliers, a supplier that received less support than a rival might be unable to compete effectively for a customer’s business. This is the case even if the supplier is the most efficient (i.e., the least cost) competitor. Despite its lower operating costs, the efficient supplier might be driven from the market by a less efficient, but more heavily subsidized, rival.<sup>58</sup>

---

tive carriers that have economies of scale or network architecture that enable the more efficient carriage of traffic); ITA Comments on *Identical Support Rule NPRM* at 3; ITTA Comments at 27. The Indiana URC’s contention ignores the fact that the identical support rule, by encouraging competitive entry through a funding mechanism that is competitively neutral, is intended to reward more efficient operations. That, in fact, is the point of competition, and provides direct benefits to consumers.

<sup>55</sup> RICA Comments at 15. *Accord* ITTA Comments at 28; KIRTC Comments at 3.

<sup>56</sup> *See* Cellular South Comments at 7 (“One clear advantage to the identical support rule is that it is a competitively neutral way to allocate support to both ILECs and competitive ETCs. The identical support rule treats all ETCs equally in a given high-cost area because all receive the same per-line support. This ensures that no provider or technology is favored over another.”).

<sup>57</sup> U.S. Cellular Comments at 8-9. Detractors of the identical support rule, such as CenturyTel, RICA, ITTA, and KIRTC, miss the point in arguing that the rule is “inherently arbitrary” (KIRTC Comments at 3) because it bases support on another carrier’s embedded per-line costs. The Commission has reasonably and consistently maintained that, in order for universal service mechanisms and pro-competitive policies to work in tandem to bring affordable and comparable services to consumers in rural and other high-cost areas, high-cost disbursements must be made in a way that does not give any service provider a competitive advantage. The only way to do this, the agency has correctly concluded, is for all carriers to receive the same level of per-line support.

<sup>58</sup> Sappington Paper at 4 (footnote omitted). The Sappington Paper is attached as Exhibit 2.

The Commission has repeatedly endorsed the view that portability — whereby incumbents and competitors receive the same level of funding — is a critical component of competitive neutrality. The agency has explained that the identical support rule is intended to overcome the competitive disadvantage faced by potential entrants, a disadvantage stemming from incumbent LECs' access to much greater levels of implicit support. The Commission has pursued a policy of converting this implicit support to explicit support, and then ensuring that the explicit support is fully portable among all ETCs, based on the agency's conclusion that this approach will lessen the competitive advantage enjoyed by incumbents and encourage competitors to enter rural and other high-cost markets.<sup>59</sup> KRITC's unsupported argument that the identical support rule has not generated any public benefits<sup>60</sup> ignores the fact that the rule promotes competitive entry, and the presence of competition in rural and other high-cost markets bestows public benefits by applying market pressures to the subsidized rates and inefficient operations of incumbent providers.

Embarq embraces the obverse of CenturyTel's argument, claiming that it *would* be competitively neutral to require that competitive ETCs must make some type of cost showing in or-

---

<sup>59</sup> See *Federal-State Joint Board on Universal Service; Access Charge Reform*, CC Docket No. 96-45, CC Docket No. 96-262, *Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report and Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking*, 14 FCC Rcd 8078, 8082 (para. 9) (1999) (“*USF Seventh Report and Order*”); see also *Access Charge Reform, Price Cap Performance Review for LECs, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, *Order on Remand*, 18 FCC Rcd 14976, 14978-79 (para. 5) (2003) (“One of the primary purposes of universal service support is to help provide access to telecommunications service in areas where the cost of such service otherwise might be prohibitively expensive. . . . The Commission has approached this goal by, among other things, pursuing reforms intended to make universal service explicit and portable to competitive carriers.”) (footnotes omitted); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Ninth Report and Order and Eighteenth Order on Reconsideration*, 14 FCC Rcd 20432, 20480 (para. 90) (1999) (“*USF Ninth Report and Order*”) (“*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). RICA's claim that the identical support rule has no “plausible theory underlying it” ignores these Commission findings. See RICA Comments at 15. TracFone argues that the rule should be eliminated because there is no basis for providing high-cost support to any carrier based on another carrier's historical costs, “especially where the former provider is able to provide adequate service at lower costs than the latter.” TracFone Comments at 9. This contention, however, ignores the Commission's explanation of the policy basis for the rule, namely, that only equal per-line support and portability can neutralize the inherent advantages of the incumbent carrier over potential new entrants.

<sup>60</sup> KRITC Comments at 5.

der to receive high-cost support.<sup>61</sup> This contention is equally unpersuasive, since it reveals a misunderstanding of the rationale for and purpose of competitive neutrality. The Commission has made plain from the outset that universal service mechanisms and rules must not “unfairly advantage [or] disadvantage one provider over another . . . .”<sup>62</sup> The Commission has further found, taking its cue from the *Alenco* decision,<sup>63</sup> that, in order for high-cost mechanisms to avoid imparting any unfair competitive advantages or disadvantages, support must be “portable among eligible telecommunications carriers.”<sup>64</sup> Since imposing an embedded cost methodology on

---

<sup>61</sup> Embarq Comments at 10. *Accord* ATA Comments at 6; GVNW Comments at 12; Oklahoma CC Comments at 10. The Oklahoma CC argues that basing wireless competitive ETCs’ support on their own costs is more competitively neutral than the identical support rule because incumbent LECs face various regulatory burdens that are not imposed on wireless competitive ETCs. Oklahoma CC Comments at 10; *see* ITTA Comments at 27. This argument ignores the fact that a principal purpose of the identical support rule is to promote competitive entry that will in turn ensure that consumers in rural and other high-cost areas have access to affordable services that are comparable to those available in urban areas. The rule promotes competitive entry by seeking to neutralize the built-in competitive advantage held by incumbent LECs who have constructed their networks in a monopoly environment with the benefit implicit ratepayer subsidies. Moreover, it is not clear that incumbent LECs face disproportionate regulatory burdens. The Joint Board has made claims similar to those of the Oklahoma CC, arguing that “[f]undamental differences exist between the regulatory treatment of competitive ETCs and incumbent LECs.” *Federal-State Joint Board on Universal Service*, WC Docket No. 05, 337, CC Docket No. 96-45, *Recommended Decision*, 22 FCC Rcd 8998, 9001 (para. 6) (2007). But the Commission opted not to rely on this assertion in acting on the Joint Board’s recommendation to impose an interim cap on wireless competitive ETC high-cost funding. *See Interim Cap Order*. The Joint Board cited as one of the “fundamental differences” the fact that wireless competitive ETCs are not subject to rate regulation. Sprint Nextel has explained, however, that rate regulation has hardly been a hardship for incumbent LECs:

[R]ate regulation has provided [ILECs] with decades of high-cost support, and decades of cost-of-service regulation complete with a generous rate of return (which is routinely exceeded). Rate regulation has enabled ILECs to recoup in full many of the costs which CETCs scramble to recover in far more uncertain circumstances (i.e., in a competitive market).

Sprint Nextel Comments in WC Docket No. 05-337 and CC Docket No. 96-45, filed June 6, 2007, at 8. Moreover, according to the New Jersey DRC, “in many jurisdictions where ILECs have been granted regulatory flexibility, they have raised rates.” New Jersey DRC Comments at 4, n. 10 (citation omitted). The New Jersey DRC also points out that, under the current regulatory regime, “[t]he way in which ILECs assign and allocate common plant and expenses harms consumers because they bear the cost of plant and yet ILECs use the common platform to provide lucrative unregulated services, the revenues from which flow to shareholders.” *Id.* at 42.

<sup>62</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776, 8801 (para. 47) (1997) (“*USF First Report and Order*”) (subsequent history omitted).

<sup>63</sup> *Alenco*, 201 F.3d at 616 (universal service subsidies “must be portable”).

<sup>64</sup> *USF First Report and Order*, 12 FCC Rcd at 8788 (para. 19). In the *Interim Cap Order*, the Commission appears to have had second thoughts regarding whether *Alenco* “requires equal per-line support for all competitors.” *Interim Cap Order* at para. 16. But *Alenco* plainly states that portability is necessary to ensure that all market participants are treated equally, and that this principle of equal treatment is made necessary by the Act. *Alenco*, 201 F.3d at 616. If per-line support is portable, it must also be equal, which would make it difficult to conclude that *Alenco* does not require equal per-line support. Undaunted, however, the Commission proceeds to explain in the *Interim Cap Order* that *Alenco* “does not require the Commission to continue to provide identical levels of support to all carriers. It

competitive ETCs would be done at the expense of portability, there is no basis for Embarq’s unexplained assertion that such a methodology would be competitively neutral.<sup>65</sup>

Embarq seeks to press its argument even further, claiming that “[u]niversal service is not about promoting competition . . . .”<sup>66</sup> As the Commission has noted, this claim is correct as far as it goes.<sup>67</sup> But Embarq and other commenters making this argument ignore the central question that should be asked, namely, what is the Act about? As the Commission has explained, relying again on *Alenco*, the Act is about making sure that the “Commission . . . ‘see[s] to it that *both* universal service and competition are realized; one cannot be sacrificed in favor of the other.”<sup>68</sup>

---

merely requires that all ETCs must be *eligible* to receive support . . . .” *Interim Cap Order* at para. 17 (emphasis added). The Commission’s reasoning is unconvincing, because it garbles the plain words and meaning of *Alenco*. The court said that (1) the high-cost program must treat all market participants equally, which (2) requires that subsidies must be portable, because (3) the market must determine who competes for and delivers services to customers, which (4) is a principle made necessary by the statute, because (5) the Act requires that all ETCs must be eligible to receive support. *Alenco*, 201 F.3d at 616. Thus, the Commission is wrong in claiming that *Alenco* “merely requires” eligibility and no more. The court in *Alenco* explained that the statute requires eligibility, and then the court held that this statutory requirement of eligibility drives the necessity of equal treatment. Equal treatment requires portability, which, in turn, requires equal per-line support. The Commission therefore cannot defend its conclusion that “[n]owhere in the court’s decision did it require that all *providers* must receive equal per-line support amounts.” *Interim Cap Order* at para. 18 (emphasis in original). The agency makes one final effort to buttress its view that it is not required to provide identical levels of support to all carriers, contending that the Act does not require that all ETCs must receive support, but only that carriers meeting certain requirements are eligible to receive support. *Id.* at para. 29 & n. 86 (citing *USF First Report and Order*, 12 FCC Rcd at 8853 (para. 137)). This contention, leaving aside its merits, is inapposite. The issue regarding the identical support rule is not whether all ETCs must receive support or are merely eligible for support, but whether the Commission is obligated by the Act to ensure that the mechanisms used to actually disburse support do so in a manner that “treat[s] all market participants equally . . . .” *Alenco*, 201 F.3d at 616. *Alenco* stands for the proposition that portability — and, with it, equal per-line support — is necessary to effectuate this equal treatment.

<sup>65</sup> Windstream also attempts to argue that imposing an embedded cost methodology on wireless competitive ETCs would be competitively neutral, but its argument rests upon its incomplete statement of the Commission’s competitive neutrality principle. Windstream contends that competitive neutrality requires that funding must be determined “without regard to technology used to deliver the service[.]” Windstream Comments at 22, but overlooks the Commission’s conclusion that “competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage or disadvantage one provider over another . . . .” *USF First Report and Order*, 12 FCC Rcd at 8801 (para. 47). As U.S. Cellular has shown, the identical support rule and portability are designed to ensure the result described by the Commission. An embedded cost regime for wireless competitive ETCs would scuttle the competitive protection at the core of the principle.

<sup>66</sup> Embarq Comments at 8. *See also* NASUCA Comments on *Reverse Auctions NPRM* at 10; NTCA Comments at 21.

<sup>67</sup> *Interim Cap Order* at para. 15.

<sup>68</sup> *Id.* (quoting *Alenco*, 201 F.3d at 615) (emphasis in original). It also should not be overlooked that a principal reason for this policy of promoting and protecting competition is to provide tangible and important benefits to consum-

The issue thus becomes whether eliminating the identical support rule would be consistent with the Commission's mandate to ensure that its universal service policies do not sacrifice competition. Given the fact that, as the Commission has further explained, the *equal* disbursement of high-cost funding ensures that neither incumbents nor competitors are unfairly advantaged or disadvantaged, eliminating a mechanism designed to ensure equal disbursement, and replacing it with a mechanism that results in unequal disbursement, would throttle competition in rural and other high-cost markets.

Finally, USTA attacks the competitive neutrality principle by arguing that universal service has gone off the tracks since passage of the 1996 Act, becoming "a tool of misguided industrial policy to encourage telecom competition through market distorting subsidies."<sup>69</sup> USTA's thesis is itself misguided and in sharp contrast to accepted economic theory about the appropriate means of providing subsidies in competitive markets. For example:

[B]y treating all suppliers symmetrically, identical support limits the ability of less efficient suppliers to drive more efficient rivals from the market. Identical support also maintains a level playing field and thereby promotes industry cost minimization over time as industry conditions change. In addition, identical support provides strong incentives to all industry suppliers to operate efficiently. By promoting ongoing industry cost minimization, identical support can both limit universal service support payments and contributions and facilitate low retail prices for consumers.<sup>70</sup>

---

ers. "Economists and regulators generally accept that competitive markets tend to produce reasonable rates that reflect the true cost of serving consumers." Mercatus Comments at 9.

<sup>69</sup> USTA Comments at 5-6. USTA, apparently in an effort to support its proposition that the competitive neutrality principle "has resulted in a poor targeting of support and a diminution of the value proposition offered to fund contributors[,] invokes Metcalfe's law of network effects, which, according to USTA, holds that "the value of a telecommunications network is proportional to the square of the number of users of the system ( $n^2$ )." USTA then opines that "[a] universal service system that does not add users to the network or retain users on the network does not add value to the network, and thus is a poor expenditure by participants in the system." *Id.* at 6. It is evident, then, that the current universal service system's failure to provide for the portability of funding may be detracting from the value of the network, since the level of per-line funding provided to incumbent LECs is increased as a direct result of their losing access lines. It could be argued, however, that this deficiency is offset by the fact that competitive ETCs are gaining lines.

<sup>70</sup> Sappington Paper at 7.

Moreover, USTA’s attack flies directly in the face of the Commission’s clear explanation that competitive neutrality ensures that “[regulatory] 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.”<sup>71</sup>

Market distortions are perpetrated and perpetuated by subsidizing protected monopolies, to the detriment of consumers. Opening up rural and high-cost markets with equal and portable support fosters competition and forces efficiencies on incumbents, for the benefit of consumers.<sup>72</sup> The market distortion that the Commission should be concerned about is not the availability of funding to competitive ETCs (which, in fact, is *not* a market distortion), but rather the lack of portability of high-cost funding. Were the Commission to endorse unequal support, universal service *would* go off the tracks in that industrial policy would encourage the re-monopolization of large portions of rural America, precisely the problem the 1996 Act intended to cure.<sup>73</sup>

Continuing the same level of high-cost support to incumbent LECs, even as the incumbents lose access lines, turns universal service into a tool of market distortion because it gives incumbents no incentive to operate more efficiently or to be more responsive to consumers’ demands for better and more affordable service. As Alltel explains, “[p]ortable high-cost support funding for a competitive entrant as well as for an ILEC does not artificially ‘create competi-

---

<sup>71</sup> *USF First Report and Order*, 12 FCC Rcd at 8802 (para. 48). See CTIA Comments at 13 (“competitive and technological neutrality enjoys nearly universal support as a bedrock legal principle”).

<sup>72</sup> See Sappington Paper at 7 (“Because identical support helps to ensure that the more efficient supplier prevails in the marketplace, identical support provides strong incentives for incumbent suppliers and competitors alike to constantly strive to reduce their operating costs.”).

<sup>73</sup> See Sappington Paper at 9-10 (“The Commission’s Asymmetric Support Notice (¶¶13-19) identifies some of the many controversial issues that will need to be resolved in order to implement a cost-based asymmetric support policy. Resolution of these issues will be complex, costly, and unavoidably imperfect, raising the possibility that inefficient suppliers will thrive while efficient suppliers are driven from the market.”).

tion.’ Rather, *it removes an artificial barrier to competition that was imposed by the pre-existing, monopoly-oriented universal service regime.*”<sup>74</sup>

**b. Commenters Favoring Repeal of the Identical Support Rule Do Not Explain Why the Issue of Substitutability Between Wireline and Wireless Voice Services Supports Elimination of the Rule.**

The Commission, implicitly acknowledging the difficulty of reconciling elimination of the identical support rule with the dictates of the agency’s own principle of competitive neutrality, came up with a theory in the *Identical Support Rule NPRM* that seeks to avoid this dilemma. The Commission tentatively adheres to the view that, since wireless voice service is not a “complete” substitute for wireline voice service, the two services should not be viewed as being in competition with each other and, therefore, any absence of equal high-cost funding could not be deemed to fail the competitive neutrality test because there is no competition for the test to protect.<sup>75</sup>

The thrust of the Commission’s argument is that it made a mistake back in 1997 — it did not anticipate the extent to which rural consumers would acquire wireless services while at the same time retaining their wireline services.<sup>76</sup> Because of the Commission’s unwillingness to require full portability, this mistake (according to the Commission) has led to unanticipated growth in the fund and has also demonstrated that the identical support rule has not worked in the way the Commission expected.<sup>77</sup> The Commission next tentatively concludes that the best way to cor-

---

<sup>74</sup> Alltel Comments at 8, n. 13 (emphasis added).

<sup>75</sup> *Identical Support Rule NPRM*, 23 FCC Rcd at 1473 (para. 12) (“We seek comment on whether this proposal [to eliminate the identical support rule] is consistent with the goal of competitive neutrality, given that the majority of competitive ETCs generally do not sell services that consumers view as direct substitutes for wireline services.”).

<sup>76</sup> *Id.* at 1471 (paras. 8-9).

<sup>77</sup> *Id.* at 1471-72 (para. 10).

rect this mistake is to eliminate the identical support rule, since the rule is the cause of the problem.<sup>78</sup>

The views and conclusions about substitutability expressed by the Commission in the *Identical Support Rule NPRM* found their way (virtually word for word) into the *Interim Cap Order*.<sup>79</sup> But the Commission in the *Interim Cap Order* stopped short of subscribing to the notion that the purported lack of “complete” substitutability provided an opportunity to sidetrack the principle of competitive neutrality. Instead, the Commission explained that the principle did not stand in the way of the agency’s adoption of an interim cap on competitive ETC high-cost funding because the Commission was not departing from the principle, but was instead merely “temporarily prioritizing the immediate need to stabilize high-cost universal service support and ensure a specific, predictable, and sufficient fund.”<sup>80</sup>

While offering assurances that it was not departing from the principle of competitive neutrality “as a matter of policy,”<sup>81</sup> the Commission made the enigmatic observation in the *Interim Cap Order* that, “as discussed above, it is not clear that identical support has, in reality, resulted in competitive neutrality.”<sup>82</sup> This comment is puzzling in two respects. First, the above discussion in the *Interim Cap Order* to which the Commission alludes presents the agency’s views about whether wireless service is a complete substitute for wireline service and how this issue

---

<sup>78</sup> *Id.* at 1473 (para. 12).

<sup>79</sup> Compare *Identical Support Rule NPRM*, 23 FCC Rcd at 1471 (para. 9) with *Interim Cap Order* at para. 20. Given the fact that the Commission sought comment on these views and conclusions in the *Identical Support Rule NPRM* (23 FCC Rcd at 1473 (para. 12)), and the record is still open in this proceeding, U.S. Cellular assumes that the agency’s views regarding substitutability are subject to further deliberation in this proceeding (notwithstanding the actions taken in the *Interim Cap Order*) as the Commission seeks to make findings and determinations on matters that were the subject of the agency’s solicitation of comments in this proceeding.

<sup>80</sup> *Interim Cap Order* at para. 22 (footnote omitted).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

may relate to increased disbursements from the high-cost fund.<sup>83</sup> The discussion does not seem to bear any relation to competitive neutrality *per se*.

And, second, the Commission's claim that identical support may not have *resulted* in competitive neutrality is confusing because, in fact, identical support *is* competitive neutrality. In other words, the provision of high-cost support on an equal basis to all ETCs ensures that no ETC is competitively advantaged or disadvantaged by the provision of support. It is therefore inherently competitively neutral on its face. The marketplace is not skewed by any ETC's receiving a greater or lesser level of support than any other ETC. With universal service support thus taken out of the competitive equation, competitive entry is promoted and competition is able to take root in rural and other high-cost areas. In contrast, as the Commission has explained, *unequal* support disbursements undermine this competitive parity and its attendant benefits.<sup>84</sup>

Some of the commenters supporting the Commission's proposal to repeal the identical support rule endorse the agency's views regarding substitutability,<sup>85</sup> but they refrain from commenting on the issue of whether the purported lack of complete substitutability means that elimination of the identical support rule would not necessarily conflict with the competitive neutrality principle.

Opponents of the proposed repeal of the identical support rule join U.S. Cellular in taking issue with the significance the Commission attempts to place on the presence or absence of "complete" substitutability between wireless and wireline services. Sprint Nextel, for example, suggests the Commission's concern about the lack of sufficient competition between wireless and wireline carriers is misplaced, and that the agency's proposed solution to the perceived prob-

---

<sup>83</sup> *Id.* at paras. 19-21.

<sup>84</sup> *E.g.*, *USF Ninth Report and Order*, 14 FCC Rcd at 20480 (para. 90).

<sup>85</sup> *See, e.g.*, NASUCA Comments on *Joint Board Comprehensive Reform NPRM* at 21; NECA Comments at 8-11; WTA Comments at 22. *But see* Embarq Comments at 7 ("Today's market is dominated by intermodal competition . . .").

lem would have detrimental effects.<sup>86</sup> Some commenters have claimed that the identical support rule and portability have subverted competitive neutrality because wireless competitive ETCs have not fully replaced wireless lines, but have simply added to the total number of access lines.<sup>87</sup> Alltel explains that this is not a basis for repealing the rule:

[T]he FCC in 1997 expressly provided that CETCs would receive support for “new customer lines” as well as for lines “capture[d]” from the ILECs. Contrary to the [*Identical Support Rule*] *NPRM*, the increased availability of wireless service in rural areas, and rural consumers’ decisions to purchase services from wireless CETCs, are not problems; they are among the greatest successes of the fund to date.<sup>88</sup>

Finally, CTIA points out that “[t]he current system is designed primarily to subsidize legacy wireline voice networks, while American consumers have moved on to mobility and broadband[,]”<sup>89</sup> and then underscores the value provided by wireless services by noting that “[i]f one of the drivers behind universal service is to insure that people have telephone access in a health

---

<sup>86</sup> Sprint Nextel Comments at 7:

The Commission’s concern that wireless and wireline carriers are not competing sufficiently — that customers inefficiently are buying both wireline and wireless service — should not be addressed by subsidizing wireless and wireline services at different levels, as that achieves exactly the wrong result: encouraging more use of what may be the less efficient wireline technology. Instead, any reform proposal should ensure that the customers are encouraged to use the most efficient technology, and should harness competition to reduce subsidies across the board.

<sup>87</sup> *E.g.*, Alexicon Comments on *Identical Support Rule NPRM* at 2-3.

<sup>88</sup> Alltel Comments at 24 (footnote omitted) (emphasis in original). Alltel also points out that it is undeniable that incumbent LECs, competitive LECs, wireless carriers, and other providers of voice-grade communications services are in direct competition with each other, “and there is ample evidence demonstrating that consumers view the voice-grade services of these various operators as inter-modal and intramodal substitutes for one another.” *Id.* at 9. Alltel observes that “[i]t is no accident that the numbers of conventional ILEC telephone lines are declining rapidly while wireless subscribership continues to grow rapidly. Wireless is increasingly considered to be a complete substitute for wireline voice services as more consumers ‘cut the cord.’” *Id.* at 9-10. Awareness of this substitutability, and of intermodal competition generally, is shaping public policy. For example, the Missouri legislature recently passed legislation ending price cap regulation of incumbent LECs in exchanges where 55 percent of consumers have access to a local exchange provider other than the incumbent (including wireless carriers and interconnected voice over Internet protocol providers). COMM. DAILY, State Telecom Activities, May 7, 2008, at 12. *Cf.* U.S. Cellular Comments at 34-35.

<sup>89</sup> CTIA Comments at 7.

or safety emergency, the phone of choice for the vast majority of Americans — young and old, male and female, poor and rich — is a cell phone.”<sup>90</sup>

The record does not provide any support for the Commission’s narrowly drawn analysis that the elimination of the identical support rule would not violate the competitive neutrality principle because wireless service is not a complete substitute for wireline service. As U.S. Cellular has indicated, the Commission’s theory incorrectly implies that wireless and wireline services do not compete against each other and that, therefore, the competitive neutrality principle is not triggered and can be left on the sidelines.<sup>91</sup> The biggest problem to be solved in rural areas is wireless service quality and availability. U.S. Cellular has observed that in every area where its service quality and availability rival wireline networks, cord cutting increases. Professor Sappington similarly concludes:

If the price of wireless service were to decrease significantly and/or if the quality of wireless service were to increase significantly in rural areas, many more customers, including rural customers, might choose to purchase only wireless service. Therefore, the purchasing pattern noted by the Commission does not imply that consumers necessarily view wireline and wireless services to be complements rather than substitutes.<sup>92</sup>

U.S. Cellular has further demonstrated that wireless services can compete against wireline services without being “complete” substitutes,<sup>93</sup> that, in fact, recent data show that consumers are increasingly “cutting the cord” and opting for exclusive use of wireless services, and that

---

<sup>90</sup> *Id.* at 4 (quoting New Millennium Research, *Cell Phones Provide Significant Economic Gains for Low-Income American Households: A Review of Literature and Data from Two New Surveys*, Nicholas P. Sullivan (Apr. 2008) at 16). *See also* New Jersey DRC Comments at 36 (noting that “[a]ccess to wireless service enhances the public safety for all consumers, and, as pay phones disappear, wireless deployment has become increasingly important to consumers’ welfare and safety”).

<sup>91</sup> U.S. Cellular Comments at 32.

<sup>92</sup> Sappington Paper at 13 (footnote omitted).

<sup>93</sup> U.S. Cellular Comments at 32-36. *Accord* ITTA Comments at 22 (arguing that, despite the Commission’s finding that consumers do not necessarily view wireless voice services as *per se* substitutes for wireline voice services, wireless voice services “are capable of exerting competitive pressures on wireline service”).

this trend is likely to gain momentum in the future.<sup>94</sup> A study recently submitted by OPASTCO supports these conclusions, finding that “[i]t is expected that lines [of small rural incumbent LECs] will continue to fall over the next three years as competition from VOIP service, *wireless substitution*, cable telephony, and substitution of broadband services for second lines continue to take their toll.”<sup>95</sup> The Lehman Study also indicates that line loss for Tier 2 cost companies has reached a rate of 6 percent per year,<sup>96</sup> but, meanwhile, the mean annual *increase* in high-cost support disbursed to rural incumbent LECs for the past six years has been 4.44 percent.<sup>97</sup>

The North Dakota Public Service Commission (“North Dakota PSC”) has provided a further illustration of these trends in wireless substitutability. The current number of wireless phones has increased in North Dakota by nearly 6 percent from last year, while the number of landline phones has decreased by nearly 3.4 percent during the same period.<sup>98</sup> This trend has been attributed by North Dakota PSC Commissioner Tony Clark to the fact that more people consider wireless phones to be a convenient alternative to traditional wireline phones.<sup>99</sup>

Given the fact that wireless and wireline services compete against each other — a conclusion that is inescapable based on any reasonable measure — it becomes difficult to maintain that the principle of competitive neutrality can be ignored as the Commission weighs its policy options for modifying high-cost funding mechanisms. Further, the Commission’s adherence to the

---

<sup>94</sup> U.S. Cellular Comments at 38-42.

<sup>95</sup> OPASTCO, Written Ex Parte Presentation, WC Docket No. 05-337, CC Docket No. 96-45, CC Docket No. 01-92, May 27, 2008, Attachment, Dale Lehman, “The Next Three Years: Likely Revenue Scenarios for Rural Incumbent Local Exchange Carriers” (“Lehman Study”) at 8 (emphasis added).

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 9.

<sup>98</sup> North Dakota Public Service Commission, News Release, “Use of Wireless Phones Continues To Increase in North Dakota,” May 27, 2008.

<sup>99</sup> *Id.*

narrow view that wireless services are not “complete” substitutes for wireline services would ignore powerful and demonstrable consumer trends.<sup>100</sup>

Unfortunately, the Commission leaves rural consumers out of the calculus. The agency’s approach presumes that rural consumers’ subscribing to multiple wireless lines is a result that should not be promoted by the Commission’s policies. But this reasoning is a disservice to rural consumers. These consumers are simply making choices comparable to those made by consumers in urban markets, taking advantage of the opportunity to utilize wireless services that are affordable and that meet many of their needs more efficiently and effectively than wireline service.

Low-income rural consumers are potentially the most adversely affected by the Commission’s policies.

If an increased incidence of cutting the cord constitutes stronger evidence that consumers view wireline and wireless services to be substitutes, then the data suggest that low-income households – the households for which universal service policies likely are most crucial – are particularly likely to view wireline and wireless services as substitutes. Consequently, the many advantages of identical support in promoting universal service may be particularly valuable for the individuals that are likely to benefit the most from universal service policies.<sup>101</sup>

The higher incidence of cord-cutting in urban areas is driven in large part by the higher-quality of wireless networks and the propensity for lower-income consumers to cut the cord, simply because they do not have the luxury of multiple telephone subscriptions.

---

<sup>100</sup> As Centennial explains, “[t]he policy implication of these trends is that it is no longer reasonable to view landline service as the ‘default case’ on which universal service policy should be based.” Centennial Comments at 7. Centennial argues that “[t]here is certainly no reason to think that when a landline line goes out of service, the investment associated with that line should remain in the cost base for determining universal service support.” Id. The New York PSC has examined trends regarding intermodal competition, and has found that wireless carriers and other service providers are competing with wireline companies to provide telecommunications services, and that historical data does not adequately capture the prospective environment in the competitive marketplace. “Establishing our policy for the future based on that history is unwise.” New York PSC, *Examination of Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, Case 05-C-0616, *Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings*, issued Apr. 11, 2006, at 33, cited in New York PSC Comments at third page (unpaginated) (noting that wireless services and certain other services “are sufficiently close substitutes for traditional wireline local service”).

<sup>101</sup> Sappington Paper at 14.

Rural consumers who value a mobile phone more than a fixed line phone are denied the ability to make that choice when service quality and availability are inadequate, yet they are penalized with having to contribute to universal service mechanisms that do not deliver the intended benefits. They must either find a way to “afford” multiple telephone subscriptions or forego a wireless phone simply because of income limitations. Improving wireless networks in rural areas is a far superior means of reducing the overall economic burden on low-income rural consumers than reducing the size of the fund to save seventeen cents per month on a consumer’s universal service contribution.

If the Commission repeals the identical support rule, there can be no doubt that these opportunities for rural consumers will be adversely affected.<sup>102</sup> If the Commission seeks to follow the statutory mandate of ensuring sufficient and comparable services for rural consumers, while at the same time addressing its concerns about the sustainability and sufficiency of the high-cost fund, then it has many options at its disposal that would neither disadvantage rural consumers nor ignore the competitive neutrality principle.<sup>103</sup>

### **3. Supporters of the Commission’s Proposal To Repeal the Identical Support Rule Fail To Demonstrate That Public Policy Goals Compel Repeal of the Rule.**

U.S. Cellular examines in this section two additional claims offered by the Commission and supported by some commenters as a justification for eliminating the identical support rule, namely, that the rule has not promoted efficient investment by wireless competitive ETCs and that the rule has led to the inefficient funding of services by multiple wireless carriers in the same geographic areas. Neither of these concerns is justified.

---

<sup>102</sup> Cf. Telecompetitor, “Interim USF Cap May Slow Wireless Substitution in Rural Areas,” May 4, 2008, accessed at <http://telecompetitor.com/node/624> (indicating that the interim wireless competitive ETC cap imposed by the Commission “may slow additional rural wireless deployments, and thus temporarily slow wireless substitution in rural areas. Many rural carriers have identified wireless substitution as their most immediate competitive threat.”).

<sup>103</sup> See the discussion in Section II.B., *infra*.

**a. The Identical Support Rule Promotes Efficient Investment by Wireless Competitive ETCs.**

Commenters arguing that the identical support rule does not promote efficient investment by wireless competitive ETCs make two main arguments.<sup>104</sup> First, they contend that wireless carriers have the opportunity to “cream skim” by seeking ETC designations in areas where they are already operating profitably without any high-cost support.<sup>105</sup> But the Commission rejected this line of argument more than a decade ago, finding that, because competing ETCs are required to provide services and advertise their services throughout their entire service areas, they cannot seek to maximize profits by limiting service to low cost areas. The Commission concluded that, if the competitive ETC “can serve the customer’s line at a much lower cost than the incumbent, this may indicate a less than efficient ILEC.”<sup>106</sup> Moreover, as U.S. Cellular demonstrated in its Comments, wireless competitive ETCs are required to use all their high-cost support to build, upgrade, and maintain the networks and facilities needed to provide service in rural and other high-cost areas, and they must also provide detailed evidence in many states that shows how high-cost funds are being used to develop and maintain these networks and facilities.<sup>107</sup>

---

<sup>104</sup> As with the issue of substitutability discussed in Section II.A.2.b., *supra*, we note that, although the Commission sought comment in the *Identical Support Rule NPRM* regarding the issue of wireless competitive ETC investment incentives, the agency appears to have reached final determinations about this issue in the *Interim Cap Order*, notwithstanding the fact that the record has not yet closed in the *Identical Support Rule NPRM* proceeding. See *Identical Support Rule NPRM*, 23 FCC Rcd at 1471-72 (para. 10), 1473 (para. 12); *Interim Cap Order* at para. 21. U.S. Cellular has proceeded here on the assumption that, notwithstanding the actions taken in the *Interim Cap Order*, the issue is still open and awaiting further deliberation and resolution by the Commission.

<sup>105</sup> ATA Comments at 4; Embarq Comments at 10-11; NTCA Comments at 21-22; TCA Comments at 6.

<sup>106</sup> *USF First Report and Order*, 12 FCC Rcd at 8933 (para. 289).

<sup>107</sup> U.S. Cellular Comments at 26-28. U.S. Cellular has also provided examples showing that the facilities that it has constructed in states in which it receives high-cost support provide coverage that far exceeds coverage provided by unsubsidized carriers. *Id.* at 26-27 & Exhibits 3 & 4. The statutory and regulatory requirements applicable to the build-out responsibilities of wireless competitive ETCs, as well as the evidence provided by U.S. Cellular regarding the coverage provided by its networks, rebut claims that the identical support rule has not promoted investment by wireless competitive ETCs in rural and other high-cost areas. ITTA contends that “[t]he evidence . . . indicates that an alarming amount of CETC support has not resulted in any public benefit, particularly when funding has been used to support multiple competitive carriers in a single market.” ITTA Comments at 34. ITTA’s erroneous claims about support to multiple wireless competitive ETCs are rebutted in Section II.A.3.b., *infra*. ITTA’s assertion that high-cost support utilized by competitive ETCs does not result in any public benefit is not credible. For one thing,

And, second, these commenters contend that, since wireless carriers receive increased per-line support as incumbents lose lines, the wireless carriers do not have any incentive to invest in infrastructure to expand and improve their services and operations in rural and other high-cost areas.<sup>108</sup> This argument, however, ignores the fact that the identical support rule encourages efficient investment and efficient operations by wireless competitive ETCs because wireless carriers will not enter a rural or other high-cost market unless they conclude that they can invest and operate more efficiently than the incumbent and therefore provide service at more affordable rates. Moreover, wireless carriers are required by the Commission's rules<sup>109</sup> and their designation grants to utilize the high-cost support they receive to build out infrastructure in the areas in which they have been authorized to provide service.<sup>110</sup>

Finally, Alltel draws attention to a salient point in commenting that the agency "fails to even consider the counterproductive impact of the existing fund mechanisms on ILEC investment incentives."<sup>111</sup> The Commission and its supporters in the record are wrong in assuming that the identical support rule is problematic because of the manner in which competitive ETCs re-

---

the Act, the Commission's rules, and requirements imposed by state commissions are designed to ensure that public benefits are derived from funding disbursements to competitive ETCs, and competitive carriers are accountable for using this funding to provide affordable service in rural and other high-cost areas. In addition, the Commission does not agree with ITTA's protestations. *See, e.g., Federal-State Board on Universal Service, Smith Bagley, Inc., Petition for Designation as an Eligible Telecommunications Carrier for the Navajo Reservation in Utah*, CC Docket No. 96-45, *Order*, 22 FCC Rcd 2479, 2487 (para. 25) (Wireline Comp. Bur. 2007) (cited in U.S. Cellular Comments at 30, n. 79) (acknowledging that wireless service mobility is vital in rural areas).

<sup>108</sup> OPASTCO Comments at 12; Qwest Comments at 6; USTA Comments at 17.

<sup>109</sup> *See* 47 C.F.R. §§ 54.202(a)(1)(ii), 54.209(a)(1). *See also* 47 U.S.C. § 254(e).

<sup>110</sup> ATA argues that the identical support rule is "an invitation to abuse" because, since competitive ETCs are not "accountable for [their] own cost justification," it is "virtually impossible to validate" whether high-cost funds "are used for the purpose of providing supported services . . ." ATA Comments at 4. ITTA makes a similar argument, claiming that the identical support rule "is opposed diametrically to the notion of supporting a carrier's costs, since it promotes circumstances in which providers receive recovery on the basis of costs they did not incur." ITTA Comments at 26 (footnote omitted). These arguments have no basis since the universal service mechanism was never intended to be a vehicle for "cost recovery." It is intended to provide support to high-cost areas, sufficient to enable consumers to achieve the goals of Section 254 of the Act. Moreover, it is U.S. Cellular's experience that it has been fully accountable, under the Act, the Commission's rules, and the requirements imposed by state commissions, for the use of the funds it receives.

<sup>111</sup> Alltel Comments at 26 (footnote omitted).

ceive funding. As Alltel explains, “the real problem is that ILECs do not lose funding even when they lose customers.”<sup>112</sup> U.S. Cellular could not agree more. When you get a customer, you get support and when you lose a customer you lose support. That has been a Commission goal since shortly after the 1996 Act, but it has never been fully implemented.

**b. The Record Does Not Support a Conclusion That the Identical Support Rule Inefficiently Promotes the Operation of Multiple Wireless Networks.**

The Commission has maintained that the identical support rule has enabled the funding of multiple networks in areas that would not otherwise support any competition or any provision of service by even one carrier without a subsidy.<sup>113</sup> Verizon, reflecting the views of some commenters, supports this position by arguing that it should not be a goal of universal service funding to upgrade multiple wireless networks in rural areas, because doing so has unduly strained the current system.<sup>114</sup>

As U.S. Cellular has explained, however, this concern about the funding of multiple wireless networks in a given service area simply does not have any basis, because support is fully portable among wireless competitive ETCs. This means that support is customer-driven — if a wireless competitive ETC loses a customer to another competitive ETC, then it loses high-cost funding.<sup>115</sup> Moreover, Cellular South has explained that the portability of funding among com-

---

<sup>112</sup> *Id.* Alltel observes that “ILEC funding has been roughly static over the past five years, even though major ILECs access lines plummeted by approximately 25 percent from 2001 to 2007.” *Id.*

<sup>113</sup> *Reverse Auctions NPRM*, 23 FCC Rcd at 1500 (para. 10). *See also Identical Support Rule NPRM*, 23 FCC Rcd at 1488 (Statement of Chairman Kevin J. Martin).

<sup>114</sup> Verizon Comments at 16 (citing *Federal-State Joint Board on Universal Service*, WC Docket No. 05, 337, CC Docket No. 96-45, *Recommended Decision*, 22 FCC Rcd 20477, 20482 (para. 16) (2007) (“*Comprehensive Reform Recommended Decision*”). *See* Indiana URC Comments at 4, 10; ITTA Comments at 34; NASUCA Comments on *Identical Support Rule NPRM* at 3-5; New Jersey BPU Comments at 5; New Jersey DRC Comments at 60; WTA Comments at 23-24. Windstream contends that “there are many areas with multiple mobile CETCs all receiving universal service support for serving many of the same customers[.]” Windstream Comments at 19, but does not provide any data or statistics regarding the number of customers who simultaneously take service from more than one wireless competitive ETC.

<sup>115</sup> U.S. Cellular Comments at 14.

petitive ETCs guarantees that no upward pressure on funding can result from the provision of service by multiple competitive ETCs in a given service area.<sup>116</sup>

It also is worth noting that some rural incumbent LECs have taken the position that, since the provision of high-cost support to multiple wireless competitive ETC networks is purportedly unnecessary, this “duplicative support to multiple CETCs should be redirected to networks that truly require support [*i.e.*, these LECs’ networks].”<sup>117</sup> It apparently is the view of these carriers that the growth of the high-cost fund is not so explosive, nor is the jeopardy faced by the fund so dire, as to preclude the Commission from providing these carriers with more funding, instead of giving consumers the benefit of any reductions in the size of the high-cost fund.

Verizon also expresses concern that a substantial portion of high-cost support disbursed to wireless competitive ETCs is used to subsidize services in areas where customers are also able to receive service from carriers that are not receiving high-cost support.<sup>118</sup> In making this argu-

---

<sup>116</sup> Cellular South Comments at 6:

The fact that multiple competitive ETCs exist in high-cost areas does not cause the Fund to grow or shrink. Because of the way that the competitive ETC formula works, competitive ETCs must compete for customers and they only receive support when they attract customers. Even more, competitive ETCs lose support when they lose customers. Because competitive ETCs receive support based on line counts and not based on their costs, there is a de facto ceiling on the amount of support that can go to competitive ETCs in an area — the number of customers in that area. It makes no difference whether there are two or 200 competitive ETCs in a high-cost area because the available support will always depend on each competitive ETC’s line counts and those line counts will always be capped according to the number of customers in the area.

<sup>117</sup> ITTA Comments at 17. ITTA argues that certain larger rural carriers are worthy of this redirected support because, according to ITTA, they require “targeted” funding to compensate for the fact that support currently calculated on the basis of study area averages does not provide them with sufficient funding to recoup their costs of providing service in high-cost areas. *Id.* at 16-17. While ITTA argues that disbursements currently received by wireless competitive ETCs should be redirected to rural incumbent LECs (instead of being eliminated in order to reduce the size of the high-cost fund), ITTA at the same time expresses concern that “growth in CETC funding is precipitating sharp increases in USF payments with no apparent effective controls on that growth” and urges the Commission to “rein in Fund growth by adopting rational controls on CETC support.” *Id.* at 37. It would seem that the Commission’s efforts to rein in fund growth would be undercut if the agency were to adopt ITTA’s proposal to “redirect” wireless competitive ETC disbursements to rural incumbent LECs.

<sup>118</sup> Verizon Comments at 8 (referencing high-cost support received by Alltel and U.S. Cellular). *See also* Ohio PUC Comments at 4-5.

ment, Verizon paints with a very broad brush. It is problematic to compare services provided by wireless competitive ETCs with services provided by non-ETC wireless carriers.

The main reason for this can be found in the goals and objectives of the universal service program, *i.e.*, to promote build-outs and upgrades in rural and other high-cost areas so that standard service is converted to ubiquitous, high-quality service. Wireless competitive ETCs, unlike non-ETC carriers, have an obligation to use high-cost funding to expand and improve their services throughout their designated service areas. Non-ETC carriers are not pursuing business plans that involve building networks and providing service throughout rural and other high-cost areas. There is a significant difference between providing “some service to some consumers” and providing high-quality service to all consumers upon reasonable request. It is therefore a false comparison to argue that support to wireless competitive ETCs is excessive or otherwise unnecessary because there may be non-ETC wireless carriers operating in the same service areas.

**B. The Commission Is Criticized by Many Commenters for Its Failure To Consider Other Alternatives To Ensure the Sufficiency and Sustainability of the High-Cost Fund, and the Efficient Use of Fund Resources.**

The record reflects the view that, if the Commission is serious about reforming universal service funding mechanisms to reduce the “explosive growth” of the high-cost fund, to ensure the future stability and sufficiency of the fund, and to guarantee that high-cost funds are used efficiently for the benefit of consumers in rural and other high-cost areas, then the approach tentatively chosen by the agency to accomplish these goals is inexplicable.

In settling upon a proposal to eliminate the identical support rule, the Commission has chosen a path toward “reform” that some commenters consider to be one-sided and unfair. These commenters have suggested that the agency can right the balance by pursuing alternative measures that would have a direct and positive impact on the health of the high-cost fund and on the

provision of service to customers in rural and other high-cost areas. U.S. Cellular examines the leading proposals made by these commenters in the following sections.

**1. The Commission Should Make Rural Incumbent LECs' High-Cost Support Fully Portable.**

Several commenters suggest that an immediate step the Commission could take to serve its objective of enhancing the sufficiency and sustainability of the high-cost fund would be to make rural incumbent LECs' support fully portable. For example, Alltel explains that, “[o]ver time, ILECs’ voice-grade line counts have declined with virtually no corresponding reductions in their subsidy funding, and as a result the per-line amount of support disbursed to ILECs has ballooned, causing unnecessary fund growth that achieves no valid policy objective.”<sup>119</sup> In contrast, as Chinook points out, there is full portability among wireless competitive ETCs. If a wireless carrier loses a customer, it loses high-cost support. “This is true even though a CETC must still support its costs of spectrum, switches, tower and base station equipment covering that customer’s area, because other customers still use handsets and require signal, transport, and the many other costs of service.”<sup>120</sup>

A Commission decision to require portability of rural incumbent LEC support, in addition to complying with the mandate of the Act,<sup>121</sup> would also relieve upward pressure on the high-cost fund.<sup>122</sup> If the Commission’s concerns about the status of the high-cost fund and the need for the reform of funding mechanisms are to be taken at face value, then U.S. Cellular is confident that the agency will act expeditiously to realize the benefits that can be derived from implementing full portability. It is also important to point out that implementation of a portability

---

<sup>119</sup> Alltel Comments at 3. *See* Cellular South Comments at 7-8 (“The problem is not that all ETCs in a high-cost area receive the same amount of per-line support, it is that incumbents continue to receive the same levels of total USF support even though they are hemorrhaging customers.”).

<sup>120</sup> Chinook Comments at 5.

<sup>121</sup> *See Alenco*, 201 F.3d at 616.

<sup>122</sup> *See* the discussion in Section II.A.1.b., *supra*.

requirement would reduce the level of competitive ETC support. Competitive ETCs would no longer receive the benefit of higher per-line support that becomes available to an incumbent LEC because the current mechanism recalculates the incumbent's per-line support when the incumbent loses lines.

## **2. The Commission Should Consider Other Measures To Reform Administration of High-Cost Funding Mechanisms.**

In addition to proposals to make rural incumbent LEC funding fully portable, commenters have also suggested other steps that the Commission could take to improve the operation of funding mechanisms and enhance the opportunity of customers in rural and other high-cost areas to receive affordable services comparable to those available in urban markets.

To take one example, CTIA suggests that the Commission should “correlate the payments made to carriers under the [universal service] program and the specific outcomes produced.”<sup>123</sup> CTIA explains that such a step is necessary because currently there is no way to determine whether high-cost support is actually advancing universal service.<sup>124</sup> CTIA correctly points out that this has not been the case for competitive ETCs, “which have generally been required to demonstrate how support received will be and has been used to support or expand service in the designated ETC service areas . . . .”<sup>125</sup>

Requiring incumbent LECs to prepare and make available, on an on-going basis, detailed information tracking the use of high-cost funds and demonstrating the specific manner in which those funds have been used to further universal service goals would not only place incumbent LECs under the same regime of accountability that is currently applicable to competitive ETCs,

---

<sup>123</sup> CTIA Comments at 22 (footnote omitted).

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

but would also further ensure that consumers in rural and other high-cost areas are receiving the benefits intended by the 1996 Act and the Commission’s universal service policies.

**C. Many Commenters Demonstrate That Imposing an Embedded Cost Methodology on Wireless Competitive ETCs Would Be a Bad Idea.**

The Commission’s proposal to adopt an embedded cost methodology for wireless competitive ETCs has met with strenuous opposition in the record, largely because specific proposals made by the Commission concerning the determination of wireless competitive ETCs’ costs and related issues would be unfair, anti-competitive, and counterproductive.

**1. The Record Reflects Strong Opposition to Using the Embedded Cost Model as a Mechanism for Wireless Competitive ETCs’ High-Cost Funding.**

U.S. Cellular explained in its Comments that one of the many disadvantages of the Commission’s proposal to eliminate the identical support rule is the collateral damage that would ensue, in the form of the agency’s further proposal to impose an embedded cost funding mechanism on wireless competitive ETCs.<sup>126</sup> Several commenters agree, urging the Commission to refrain from applying the embedded cost methodology. Verizon, for example, points out that the embedded cost model “would be an overly regulatory and counterproductive approach[,]”<sup>127</sup> and urges the Commission not to “extend to competitive carriers the discredited cost-based system that currently applies to rural incumbent LECs.”<sup>128</sup>

---

<sup>126</sup> U.S. Cellular Comments at 4, 43-45.

<sup>127</sup> Verizon Comments at 19.

<sup>128</sup> *Id.* at 35. Verizon also explains that “[a]doption of this highly regulatory, cost-based approach would not solve the fund’s fundamental problems and would focus Commission resources on a complicated and uncertain interim solution instead of more meaningful long-term reform.” *Id.* See WYOCA Comments on *Identical Support Rule NPRM* at 3 (arguing that creation of a cost-based support methodology for competitive ETCs would not be the best step in an overall plan of comprehensive reform). Windstream, in proposing that rural incumbent LECs currently under price cap regulation should be moved from an embedded cost funding mechanism to a forward-looking cost mechanism, argues that such a step “would eliminate the mismatch between carriers’ basing investment decisions on a competitive marketplace, while receiving universal service support due to embedded costs.” Windstream Comments at 6. The Commission’s proposal to impose an embedded cost mechanism on wireless competitive ETCs would create just such a mismatch.

USTA joins in this criticism, stating that it “is not in favor of adding onerous layers of regulation to any industry providers whether they are incumbent ILECs or fixed or mobile competitive ETCs.”<sup>129</sup> GCI argues that “moving to an ‘own costs’ mechanism would obliterate competitive neutrality as an objective of universal service policy and would significantly blunt the ability of the market to drive the cost-effective delivery of universal service. Neither of those results is in the public interest.”<sup>130</sup>

This opposition to the Commission’s proposed utilization of the embedded cost methodology highlights the dilemma the agency has created by proposing to eliminate the identical support rule. It would be nonsensical for the agency to turn back the clock by subjecting wireless competitive ETCs to an embedded cost methodology.<sup>131</sup>

**2. Imposing a Cost Accounting System on Wireless Competitive ETCs Based on Part 32 of the Commission’s Rules, or Based on Any Similar Cost Accounting Model, Would Be Burdensome and Unfair.**

If the Commission decides to impose an embedded cost methodology, the agency would find itself stymied by the issue of how to account fairly and accurately for wireless competitive ETCs’ costs. This predicament has been amply demonstrated in the record. The Virgin Islands PSC, for example, advises the Commission to refrain from adopting a Part 32 system of accounts for competitive ETCs because such an action would likely “impose very substantial and signifi-

---

<sup>129</sup> USTA Comments at 18.

<sup>130</sup> GCI Comments at 65. GCI points out that (1) imposing an embedded cost methodology on competitive ETCs would in effect place all fund recipients under rate-of-return regulation, which would lead to inefficient operations and excessive universal service support; (2) requiring the methodology for competitive ETCs would also protect “ILECs against any marketplace consequences of inefficiency”; and (3) using the embedded cost methodology for competitive ETCs “will require the creation of complex cost allocation rules that are difficult to implement, administer and enforce, and that are wholly unnecessary for any other regulatory purpose . . . .” *Id.*

<sup>131</sup> See NCTA Comments at 12 (use of an embedded cost model “would lead to subsidization of inefficient carriers at the expense of efficient carriers”) (quoting *USF First Report and Order*, 12 FCC Rcd at 8901 (para. 228)). *Accord* Cellular South Comments at 8; Verizon Comments at 35-36. The Commission also explained that the “embedded cost [mechanism] provide[s] the wrong signals to potential entrants and existing carriers. The use of embedded cost would discourage prudent investment planning because carriers could receive support for inefficient as well as efficient investments.” *USF First Report and Order*, 12 FCC Rcd at 8901 (para. 228) (footnote omitted).

cant costs on the competitive ETC and could be a barrier to any new carrier seeking ETC designation.”<sup>132</sup> The Virgin Islands PSC “recommend[s] that the Commission continue to follow a light-handed approach in order to facilitate competitor acceptance of ETC obligations.”<sup>133</sup>

GCI also recognizes the burdens that would be caused by any attempt to develop and impose accounting systems on competitive ETCs, arguing that “[t]here can be no mistaking the overwhelming regulatory paperwork burden that the Commission would create by implementing an ‘own costs’ mechanism.”<sup>134</sup> GCI argues that creating an accounting system for competitive ETCs “is not just a matter of taking numbers from a CETC’s existing income statements and balance sheets, but would require a whole new set of rules governing accounting, cost allocation and even documentation.”<sup>135</sup> GCI notes that, “[a]lthough the authors of the WiCAC [wireless carrier actual cost] proposal pretend that it would be a simple thing to map a CETC’s costs into 23 Part 32 accounts, the Commission’s own questions [raised in the *Identical Support Rule NPRM*] reveal the many hidden complexities.”<sup>136</sup>

Verizon echoes these concerns, pointing out that quantifying costs for regulatory purposes is extremely difficult, and these problems would be heightened in the case of competitive ETCs that have never been required to maintain cost accounting records for regulatory purposes.<sup>137</sup> Cost accounting requirements would be burdensome both for the Commission and the

---

<sup>132</sup> Virgin Islands PSC Comments at 11; *see* Centennial Comments at 6. *But see, e.g.*, WTA Comments at 24-25.

<sup>133</sup> Virgin Islands PSC Comments at 12.

<sup>134</sup> GCI Comments at 70.

<sup>135</sup> *Id.* *See* WYOCA Comments on *Identical Support Rule NPRM* at 4 (arguing that imposing an embedded cost methodology on wireless competitive ETCs “would be the equivalent of starting a mini-regulatory system for wireless carriers in an era where there is little regulation of *wireline* carriers. It makes no sense in today’s regulatory environment. It would be a distraction from the real reform of universal service that should be the [Commission’s] focus . . .”) (emphasis added).

<sup>136</sup> GCI Comments at 70.

<sup>137</sup> Verizon Comments at 35.

competitive ETCs, and it would be virtually impossible to demonstrate what costs are uniquely attributable to a competitive ETC's universal service obligations.<sup>138</sup>

Imposing expensive cost reporting burdens on competitive carriers as proposed by the Commission would be exactly the opposite of the pro-competitive mandates set forth in the 1996 Act, and the Commission's own actions in related areas. Recently, the Commission granted AT&T's request for relief from various cost assignment rules set forth in Parts 32, 36, and 69 of the Commission's Rules. The Commission used language startlingly similar to that set forth by commenters in this proceeding who oppose the imposition of an "own costs" regime on competitive carriers:

[T]he Cost Assignment Rules, in this case, impose costs that outweigh their benefits. We believe that these costs likely distort the market for telecommunications services by diverting AT&T resources that would otherwise be directed to "positive activities that generate consumer benefit." We agree with Legacy BellSouth that the Cost Assignment Rules could negatively affect "innovation, efficiency and competitiveness" of services provided to consumers.

[T]he Cost Assignment Rules require AT&T to direct considerable financial and personnel resources "to utilize a complex hierarchy to track, value and record affiliate transactions, to allocate costs of regulated and non-regulated services, to maintain, update and audit its Cost Allocation Manual, to jurisdictionalize intra and interstate costs and to apportion interstate costs to interstate service baskets."<sup>139</sup>

As U.S. Cellular has previously noted, the 1996 Act requires the Commission to adopt universal service rules and policies that work alongside the increasingly competitive environ-

---

<sup>138</sup> *Id.* at 36. Several other commenters voice similar concerns regarding the burdens and unfairness of imposing incumbent LEC-based cost accounting mechanisms on wireless competitive ETCs. *See, e.g.*, Alltel Comments at 28, 30; AT&T Comments at 38, n. 56 (criticizing the wireless carrier actual cost, or "WiCAC," proposal); CTIA Comments at 25; Sprint Nextel Comments at 9-10. *See also Access Charge Reform*, CC Docket No. 96-262, *Order*, 23 FCC Rcd 2556, 25661 (para. 14) (2008), *cited in* NCTA Comments at 12 (finding that requiring competitive LECs to prepare administratively difficult cost study analyses would subject them to legacy regulation, and would thus undermine the Commission's policy objectives).

<sup>139</sup> *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules; Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Dockets 07-21, 05-342, *Memo-randum Opinion and Order*, (released Apr. 24, 2008) at paras. 36, 43.

ment, not impede competition. There is no rational policy basis to impose an “own costs” regime at a time when the agency clearly recognizes the very harms of cost assignment burdens, the minimal benefits to consumers, and the very strong consumer benefits of a vibrant competitive marketplace.

In sum, attempting to squeeze wireless competitive ETCs into some type of Part 32 cost accounting system would be unfair, in part because it would be difficult to properly and accurately account for costs that are derived from infrastructure configurations and ways of providing service that are markedly different from the incumbent LECs’ networks and operations that are the focus of Part 32. On the other hand, attempting to devise a cost accounting system geared to the unique aspects of the networks and operations of wireless competitive ETCs would bring its own challenges, in part because such an attempt would need to start from scratch, in light of the fact that wireless carriers currently are not required to maintain any cost accounting for regulatory purposes.

The only thing that is clear at this juncture is that the efforts of the Commission to sort out these issues, as reflected in the *Identical Support Rule NPRM* and as highlighted in the record, are at the half-baked stage, at best. It would be a difficult and lengthy undertaking for the agency to attempt to invent and implement a cost accounting system for wireless competitive ETCs, and the prospect of success in such an endeavor would be uncertain. Instead of pursuing such proposals, the agency should focus its efforts and resources on more even-handed and effective measures to achieve comprehensive universal service reform.

**3. It Would Be Implausible and Unfair To Determine Wireless Competitive ETCs' Support Based on National Average Benchmarks Derived from Incumbent LECs' Costs.**

The Commission has requested comment on a proposal to determine a competitive ETC's support by comparing its cost per loop to the national average cost per loop for incumbent LECs developed by NECA pursuant to Section 36.613 of the Commission's Rules.<sup>140</sup>

As Alltel explains, the use of such a benchmark “would create a systematic, downward bias for wireless support to the extent that wireless costs are *lower* (*i.e.*, generally more efficient) than wireline costs.”<sup>141</sup> Apart from the fact that this scheme would rely on incumbent LECs' costs to determine the level of competitive ETCs' support — an approach roundly (if tentatively) criticized by the Commission in its evaluation of the identical support rule<sup>142</sup> — it would also appear to ask “competitive ETCs to be as inefficient as incumbent LECs or risk losing USF support.”<sup>143</sup>

Even GVNW, a supporter of imposing an embedded cost methodology on wireless competitive ETCs, provides a somewhat fractured defense of the proposal to apply an incumbent LEC-derived benchmark to the wireless carriers' costs. GVNW notes that “using the wireline cap for the wireless companies is no more relevant for the wireless companies than it is for the wireline companies.”<sup>144</sup> Explaining that the current national benchmark does not have any basis in wireline carriers' actual costs, GVNW concludes that “[t]he wireline companies would have the

---

<sup>140</sup> *Identical Support Rule NPRM*, 23 FCC Rcd at 1476 (para. 20).

<sup>141</sup> Alltel Comments at 32-33 (emphasis in original).

<sup>142</sup> See U.S. Cellular Comments at 48.

<sup>143</sup> Cellular South Comments at 8.

<sup>144</sup> GVNW Comments at 15.

same arguments for the arbitrary and capricious treatment as would the wireless companies.”<sup>145</sup>  
This assessment hardly amounts to an endorsement of the benchmark proposal.<sup>146</sup>

**4. The Record Reveals Glaring Problems Associated with the Commission’s Proposal To Cap Wireless Competitive ETCs’ Per-Line Support at the Level of Incumbent LECs’ Per-Line Support.**

The record reflects the sentiment that the Commission’s solicitation of comment on a proposal to place a per-line ceiling on wireless competitive ETCs’ support, linked to the per-line support received by incumbent LECs,<sup>147</sup> slides the *Identical Support Rule NPRM* into the realm of the absurd.

The principal problem identified in the comments is that the proposal is self-contradictory. As CTIA explains, “[i]f the Commission were to eliminate the identical support rule and conclude that ETCs’ embedded or book costs are a reasonable basis for support, despite the obvious market distortions and incentives for inefficiency this system creates, *there is no basis to restrict wireless carriers’ support levels based on the ILECs’ costs.*”<sup>148</sup> In other words, if the Commission is intent upon disbursing support to wireless competitive ETCs based upon their own “actual costs,” how could it conceivably be reasonable to limit these disbursements based on a yardstick that is not derived from the wireless carriers’ costs, but rather from the incumbent LECs’ costs?<sup>149</sup> Alltel answers this question by observing that the “blatantly biased” proposal

---

<sup>145</sup> *Id.*

<sup>146</sup> In fact, GVNW indicates that, while the proposal “is a good starting point for the public policy debate[,]” GVNW is “open to alternative levels for the threshold if other levels are more equitable and in line with managing the limited resources associated with the Universal Service Fund.” *Id.*

<sup>147</sup> See *Identical Support Rule NPRM*, 23 FCC Rcd at 1478 (para. 25).

<sup>148</sup> CTIA Comments at 17 (emphasis added).

<sup>149</sup> Alexicon contends that capping competitive ETCs’ per-line support based on incumbent LECs’ per-line costs is necessary “to provide a *level playing field* between CETC and ILEC high-cost support.” Alexicon Comments on *Identical Support Rule NPRM* at 5 (emphasis in original). See also TCA Comments at 15. In fact, as CTIA has explained, the proposed cap would tilt the playing field: both incumbent LECs and competitive ETCs would be entitled to support based on their own costs, but only competitive ETCs — and not incumbent LECs — would be subject to a limit, and would not be able to receive disbursements based on all their own costs, if their costs exceed in-

“reveals that the true purpose of this entire exercise is simply to reduce CETC funding rather than moving toward funding based on CETCs’ ‘actual costs.’”<sup>150</sup>

GCI points out that imposing a cap on competitive ETCs’ funding based on incumbent LECs’ costs would have the perverse effect of understating “the costs of a CETC serving the high cost portions of the study area and [would] create an artificial barrier to entry in the high cost portions of the ILEC study area.”<sup>151</sup> GCI explains that this would be the case because the only costs that incumbent LECs report are study area average costs, not disaggregated costs. “Unlike disaggregation under the equal support rule, . . . this proposed cap does not give the CETC the opportunity to have a higher per line support in the high cost areas than in the low cost areas.”<sup>152</sup>

The New Jersey DRC expresses a contrary view, arguing that a per-line cap should be imposed on competitive ETCs because it would prevent the subsidization of inefficient entry.<sup>153</sup> If the New Jersey DRC favors efficient entry, then it should reconsider its opposition to the identical support rule, because the rule, by ensuring the competitively neutral disbursement of high-cost funds, promotes efficient entry. Pursuant to the operation of the rule, a wireless carrier does not have any incentive to request ETC status in a rural or other high-cost area unless it antic-

---

cumbent LECs’ costs. The proposed cap takes the playing field from level to 180 degrees (with competitive ETCs at the bottom).

<sup>150</sup> Alltel Comments at 29 (footnote omitted).

<sup>151</sup> GCI Comments at 83 (footnote omitted). GCI also argues that, if the Commission must adopt a cap, such a cap should be non-discriminatory and bilateral. “[T]he support of both the ILEC and the CETC should be capped at the lower effective per-line support for both carriers. There is no more reason for the ILEC to receive support for costs above the CETC’s than for the CETC to receive support for costs above the ILEC’s.” *Id.* at 83-84. ATA notes that it supports the proposed cap because it would “encourage efficiency in competitive ETCs’ delivery of supported services . . . .” ATA Comments at 7. If such were the case, then, as GCI suggests, it would make much more sense to cap all providers at the lower level of per-line support. Further, ATA ignores the fact that the identical support rule works to subject rural incumbent LECs to the competitive pressures of carriers that have the potential to deliver service more efficiently.

<sup>152</sup> GCI Comments at 83. *Cf.* Indiana URC Comments at 5 (noting that the Rural Task Force has indicated that the current method of reporting averaged incumbent LEC costs must be modified to be consistent with the Act and the principle of competitive neutrality).

<sup>153</sup> New Jersey DRC Comments at 61-62.

ipates being able to provide service more efficiently than the incumbent LEC. Furthermore, the New Jersey DRC overlooks the fact that it would not be competitively neutral to impose a cap on wireless competitive ETCs' per line support while continuing to permit unfettered disbursements to incumbent LECs.

The criticisms raised by several commenters confirm that the Commission should accept U.S. Cellular's suggestion to reject this per-line ceiling proposal, and to retain the identical support rule.<sup>154</sup>

#### **5. The Commission Should Reject the Proposal to Use Incumbent LEC Study Areas as a Basis for Determining Competitive ETCs' Support Disbursements**

There is some suggestion in the record that, in order to achieve competitive and technological neutrality, a competitive ETC's study area should be exactly the same as the existing study area of the incumbent LEC for purposes of determining the actual costs of competitive ETCs that are eligible for high-cost support.<sup>155</sup>

The Commission should reject the argument that requiring competitive ETCs to calculate their costs on the basis of incumbent LEC studies areas would be competitively neutral. As Alltel notes, the manner in which wireless competitive ETCs design and operate their networks is different from the design and operation of incumbent LEC networks.<sup>156</sup>

---

<sup>154</sup> See U.S. Cellular Comments at 50.

<sup>155</sup> See SWC Comments on *Identical Support Rule NPRM* at 10. SWC expresses concern that, if the competitive ETC were to have a larger study area, upon which its high-cost support is based, there could be a risk that costs other than those specifically associated with serving high-cost customers could inadvertently be added to the costs of serving high-cost customers in the incumbent LEC's study area. *Id.* See also MSTCG Comments at 6.

<sup>156</sup> Alltel Comments at 31-32. Alltel argues that "[w]ireless carriers should not be required to fit a square peg into a round hole, as it were, based on the improper and unlawful theory that universal service is inherently the province of wireline carriers . . . ." *Id.* at 32. See also GCI Comments at 72-73 (footnote omitted):

[A] CETC's network will not necessarily duplicate the ILEC's network topology. Thus, the Commission will be faced with answering questions about how to classify investments in the CETC's network that may be analogous to more than one ILEC investment category. This could require another set of rules, unless the Commission simply accepts the CETC networks as it finds them,

These differences mean that it would be burdensome for wireless competitive ETCs to somehow reconfigure the way in which they track costs and maintain financial records so that costs could be attributed to operations within incumbent LEC study areas. Equally problematic is the fact that any such requirement imposed on wireless competitive ETCs would risk the inaccurate reporting of these carriers' costs because of the difficulties associated with attempting to track those costs within the artificial confines of incumbent LEC study areas.

If the Commission decides to require that high-cost disbursements to wireless competitive ETCs must be based on their actual costs, then the agency must devise a means of measuring these costs that is competitively and technologically neutral, that takes into account the way the costs are generated by the wireless carriers' networks, and that acknowledges the differences between the design and operation of these networks and the networks operated by incumbent LECs.<sup>157</sup>

### **III. THE COMMISSION SHOULD REJECT PROPOSALS TO USE REVERSE AUCTION MECHANISMS TO DISBURSE HIGH-COST SUPPORT.**

U.S. Cellular explained in its Comments that reverse auction mechanisms should not be implemented by the Commission because they would not be consistent with pro-competitive congressional policies, nor would they ensure the continued availability of affordable, high quality services in rural and other high-cost areas.<sup>158</sup> U.S. Cellular also discussed the reasons why single-winner auctions would be particularly problematic as vehicles for the disbursement of high-cost support.<sup>159</sup> A broad cross-section of commenters has voiced the same or similar concerns.

---

and doesn't try to "force fit" CETC networks into ILEC cost accounting categories such as "loop", "switch" and "transport."

<sup>157</sup> See, e.g., RTA Comments at 7 (arguing that the minimum level of disaggregation for purposes of computing a wireless competitive ETC's actual costs should be the wireless carrier's licensed service area, e.g., the Metropolitan Statistical Area or Rural Statistical Area for which the wireless carrier holds a license).

<sup>158</sup> U.S. Cellular Comments at 55-57.

<sup>159</sup> *Id.* at 57-59.

**A. The Many Problems Associated with Reverse Auctions Make Them Unsuitable as a Mechanism for Allocating High-Cost Support.**

In addition to arguing that the concept of using reverse auctions for high-cost support is fundamentally flawed,<sup>160</sup> many commenters have pointed to a host of difficult issues that would plague any attempt to design and implement reverse auctions for use in awarding high-cost support.<sup>161</sup> Principal among these concerns is the unlikelihood that reverse auctions could be competitively neutral, if they pitted incumbent wireline carriers against wireless competitive ETCs.<sup>162</sup>

Because of the fact that incumbent LECs' networks generally are mature and fully deployed, while wireless competitive ETCs' networks generally are of a more recent vintage and are not yet fully deployed, it would be difficult for wireless carriers to be competitive in reverse auctions because they typically would face a greater level of costs associated with their need to con-

---

<sup>160</sup> *E.g.*, ATA Comments at 13 “[t]he use of reverse auctions as a mechanism for selecting ETCs and distributing high-cost support funds would represent a disruptive experiment of unimaginable proportions”); NTCA Comments at 44:

Reverse auctions assume that the public will benefit if support is limited to the least cost provider. The object of high-cost support is to ensure that consumers in rural areas receive comparable services to those received by urban consumers and that they are able to obtain those services at comparable rates. A system that limits support to the lowest bidder is highly unlikely to achieve this objective and cannot ensure that the goals of the Act will be consistently achieved throughout the United States. Support to the lowest bidder is inconsistent with the notions that companies must invest in networks to maintain service and that the evolution of the definition of universal service requires additional and timely investment in new technologies.

*See also* CoBank Comments at 3 (arguing that “[r]everse auctions have the potential to severely disrupt the provisioning of universal service to rural America”); ITA Comments on *Reverse Auctions NPRM* at 2 (arguing that “the use of a reverse auction mechanism to determine high-cost universal service support in rural ILEC service areas with preexisting infrastructure is likely to have disastrous long term consequences for rural ILECs”); ITTA Comments at 10 (“the application of competitive bidding for areas served by incumbent carriers . . . is fraught with hazards that should be avoided by utilizing alternative approaches that will fulfill the Commission’s goals without unnecessary risks”); *id.* at 36 & n. 80; North Dakota PSC Comments at 4; RICA Comments at 21-22; TCA Comments at 15; URTA Comments at 8; WTA Comments at 29.

<sup>161</sup> *See, e.g.*, New Jersey DRC Comments at 57 (opposing “reverse auctions as a way of distributing high cost [funds] because of the numerous implementation challenges that would thwart the achievement of its purported goal of achieving an efficient high cost distribution system[,]” but favoring the use of auctions on a trial basis to support broadband deployment).

<sup>162</sup> *See* Cellular South Comments at 4-5 (reverse auctions cannot be conducted in a competitively neutral manner); Sprint Nextel Comments at 12 (reverse auctions would need to ensure that wireline and wireless providers, as well as incumbents and new entrants, compete on an equal footing).

tinue the deployment of their networks in the designated service areas.<sup>163</sup> This mismatch between the different investment considerations faced by incumbents and wireless entrants would undermine any efforts by the Commission to configure reverse auctions in a competitively neutral manner.

Commenters also argue that reverse auctions would be problematic because it would be difficult for auction winners to maintain service quality,<sup>164</sup> incumbent LECs who participated in reverse auctions but did not submit winning bids could face the prospect of being unable to recoup their investment in previously deployed network facilities,<sup>165</sup> and a wireless competitive ETC that won a reserve auction could face curtailed access to the wireline network in the designated service area because the incumbent LEC (having lost universal service support as a result of losing the auction bid) would not have sufficient resources to maintain and upgrade the network.<sup>166</sup>

Opponents of reverse auctions further contend that auctions would not provide incentives for the build-out of networks,<sup>167</sup> the auctions would cause financial instability for incumbent

---

<sup>163</sup> Cellular South Comments at 4.

<sup>164</sup> ITA Comments on *Reverse Auctions NPRM* at 5-6; ITTA Comments at 39; NASUCA Comments on *Reverse Auctions NPRM* at 9; NECA Comments at 27; North Dakota PSC Comments at 4; OPASTCO Comments at 16; TCA Comments at 16; TDS Comments at 10. Tracfone agrees that concerns about service quality are legitimate, but suggests that the problem would not be insurmountable because regulators could enforce service standard obligations. TracFone Comments at 6. But any such regulatory involvement would impose administrative costs on both service providers and the regulating agencies, would require substantial, ongoing, and costly regulatory oversight in order to have any chance of being effective, and, in any event, would be less likely to succeed than reliance on the development of competitive forces in rural and other high-cost markets as a means of giving carriers the incentive to maintain high levels of service quality.

<sup>165</sup> ITA Comments on *Reverse Auctions NPRM* at 4; ITTA Comments at 39; NASUCA Comments on *Reverse Auctions NPRM* at 9; Qwest Comments at 8; RICA Comments at 22.

<sup>166</sup> NASUCA Comments on *Reverse Auctions NPRM* at 9. See WYOCA Comments on *Reverse Auctions NPRM* at 3.

<sup>167</sup> ITTA Comments at 38; NECA Comments at 27; NTTA Comments at 10; OPASTCO Comments at 16; RTA Comments at 10-11; TCA Comments at 15.

LECs who do not emerge as auction winners,<sup>168</sup> and reverse auctions are fundamentally unsuited for the pricing of complex telecommunications network services in rural and other high-cost areas.<sup>169</sup>

Commenters favoring implementation of a reverse auctions mechanism express the hope that implementation would be simple,<sup>170</sup> that reverse auctions could help control the overall cost of universal service,<sup>171</sup> that reverse auctions could ensure more efficient provision of service if the auctions were properly structured in a competitively neutral manner,<sup>172</sup> and that the need for cost of service studies would be eliminated by implementation of reverse auction mechanisms.<sup>173</sup> T-Mobile also argues that the use of reverse auctions would have the effect of mooted the Commission's proposals to repeal the identical support rule, eliminate IAS and ICLS funding for competitive ETCs, and impose an embedded cost methodology on wireless competitive ETCs.<sup>174</sup>

These arguments presented by proponents of reverse auction mechanisms are not sufficient to overcome the substantial objections raised in the record. For example, it would be difficult for the Commission to devise a "simple" structure for reverse auctions that would also adequately address the long list of problems and issues that commenters opposing reverse auctions have identified. Even though the prospect of the Commission's using reverse auctions for high-cost support has been on the table since 1997,<sup>175</sup> it is clear from the *Reverse Auctions NPRM* and

---

<sup>168</sup> Centennial Comments at 10; CoBank Comments at 4 (explaining that, "[i]f a telecommunications provider is faced with the possibility of losing access to universal service support funding through a reverse auction system, lenders will restrict the amount of debt made available"); ITA Comments on *Reverse Auctions NPRM* at 3, 4-5; IT-TA Comments at 38; NECA Comments at 27; North Dakota PSC at 4; OPASTCO Comments at 17; TCA Comments at 16; URTA Comments at 9.

<sup>169</sup> NECA Comments at 27.

<sup>170</sup> Connecticut DPUC Comments at 6.

<sup>171</sup> *Id.* at 7; New Jersey BPU Comments at 5.

<sup>172</sup> CTIA Comments at 23.

<sup>173</sup> Connecticut DPUC Comments at 6-7; T-Mobile Comments at 12.

<sup>174</sup> T-Mobile Comments at 11-12.

<sup>175</sup> *USF First Report and Order*, 12 FCC Rcd at 8947-51 (paras. 319-325).

from the record that the agency is still a great distance away from resolving these problems and issues.

Further, while arguments can be made that competitive bidding mechanisms have the potential to reduce the level of high-cost funding and to generate greater efficiencies in carriers' investment and operations, these potential benefits could very well turn out to be false economies if reverse auctions were designed and implemented in a way that fails to solve issues such as service quality, stranded investment, decreased incentives for network investments, and barriers to financing.

In addition, while it is true, as T-Mobile points out, that the use of reverse auctions would seem to make it unnecessary for the Commission to repeal the identical support rule and impose an embedded cost methodology on wireless competitive ETCs,<sup>176</sup> that fact does not provide any answers to the multiple problems identified in the record that stand in the way of devising a workable and effective auction mechanism. A better approach, which would avoid the need to solve the design and logistical problems inherent in the reverse auction mechanisms, would be for the Commission to retain the identical support rule, impose full portability on incumbent LECs, and transition rural incumbent LECs to a forward-looking cost model.

**B. The Commission Should Reject Single-Winner Auctions Because They Would Be Anti-Competitive, They Would Result in Intrusive Regulation, and They Would Cause Other Serious Problems.**

Single-winner auctions are anti-competitive, and therefore cut against the grain of the pro-competitive policies mandated by the 1996 Act. For this and other reasons, several commenters agree with U.S. Cellular that, if the Commission decides to pursue reverse auctions, it should not select single-winner auction mechanisms.

---

<sup>176</sup> T-Mobile Comments at 12.

A number of commenters argue that a significant drawback of single-winner auctions is the fact that they would have the effect of re-monopolizing rural and other high-cost service areas.<sup>177</sup> Cellular South explains the disadvantages of such a result by noting that “[t]he 1996 Act allowed competition in areas that were formerly served only by monopolies. In so doing, consumers were able to benefit from lower prices, new technologies and improved service. Proposals that eliminate competition in high-cost areas violate the principles of the 1996 Act and would strip consumers of the benefits of competition.”<sup>178</sup>

Commenters also object to the single-winner reverse auction mechanism because it would require “hyper-regulation” of the winner in order to ensure service quality and reasonable rates,<sup>179</sup> it would raise the difficult issue of whether incumbent LECs (if they are not auction winners) should be relieved of carrier-of-last-resort obligations,<sup>180</sup> it would increase the difficulties faced by rural carriers in raising capital,<sup>181</sup> and it would have a negative impact on service quality.<sup>182</sup>

Arguments advanced by supporters of the single-winner auction mechanism fall short. NASUCA, for example, contends that single-winner auctions would better target support to the most efficient service provider, and would also eliminate the waste that is inherent in the duplicate funding permissible under the existing rules.<sup>183</sup> But reverse auctions could just as easily

---

<sup>177</sup> Alltel Comments at 40 (citing *Alenco*, 201 F.3d at 622); GVNW Comments at 21 (competitive bidding would be anti-competitive by limiting customers’ access to competitive alternatives); WTA Comments at 33 (reverse auctions would provide anti-competitive opportunities in many markets). *See also* Alexicon Comments on *Reverse Auctions NPRM* at 3 (contending that a single-winner auction would create an artificial barrier to competition).

<sup>178</sup> Cellular South Comments at 6-7.

<sup>179</sup> Alltel Comments at 40-41. *See also* WYOCA Comments at 4-5.

<sup>180</sup> Embarq Comments at 18.

<sup>181</sup> GVNW Comments at 22-23 (arguing that lenders would be concerned that, if an auction winner were to lose a subsequent auction, then it would also lose further high-cost support); WTA Comments at 30.

<sup>182</sup> MSTCG Comments at 12; WTA Comments at 30.

<sup>183</sup> NASUCA Comments on *Reverse Auctions NPRM* at 10. *See also* New Jersey BPU Comments at 5; TracFone Comments at 4; USTA Comments at 20-21, 22; Verizon Comments at 14.

produce winners whose “low ball” bidding in the auction would compromise their ability to build out their networks and provide quality services.<sup>184</sup> Further, NASUCA’s concerns about duplicate funding are misplaced, because, in the case of wireless competitive ETCs, receipt of high-cost support is customer-driven, and a wireless carrier who loses a high-cost customer also loses high-cost support.<sup>185</sup>

The Florida PSC favors single-winner auctions because of the prospect that they would shrink the overall size of the high-cost fund.<sup>186</sup> But, as U.S. Cellular has discussed in its Comments and in these Reply Comments, there are other ways to manage the size and efficiency of the high-cost fund, that do not involve the re-introduction of a monopoly-based funding system.<sup>187</sup> Moreover, Section 254 of the Act sets forth a core principle that support must be sufficient to achieve the Act’s goals; there is nothing requiring the Commission to minimize size of the fund.

Finally, Windstream suggests that reverse auctions should be implemented on a trial basis in areas currently served by multiple wireless competitive ETCs, as a means of limiting support to only one such carrier in each service area.<sup>188</sup> This proposal should be rejected. The shortcomings and risks of reverse auctions that have been identified by U.S. Cellular and other commenters make it inadvisable to pursue this mechanism even on a trial or experimental basis.

Further, even if the Commission were to proceed with trial or experimental reverse auctions, there would be no credible policy basis for restricting these initial auctions to wireless

---

<sup>184</sup> *E.g.*, WTA Comments at 32-33.

<sup>185</sup> See Section II.A.3.b., *supra*.

<sup>186</sup> Florida PSC Comments at 4-5.

<sup>187</sup> In this regard, Qwest bases its support of single-winner auctions on its view that “[u]niversal service is not intended to and should not be used to promote competition.” Qwest Comments at 8. This argument misses the point. The Act, in keeping with its pro-competitive policies, requires that universal service mechanisms must be competitively neutral. Single-winner auctions, by freezing out competitors and re-establishing a monopoly funding regime, would not be consistent with statutory mandates or the principle of competitive neutrality.

<sup>188</sup> Windstream Comments at 24-25.

competitive ETCs. Any such trials encompass all ETCs, so that the Commission would be in a better position to make informed judgments and decisions about whether to pursue a more extensive implementation of reverse auctions. There would be no need to single out wireless carriers providing service in the same area because, as U.S. Cellular has explained, high-cost funding is fully portable among wireless competitive ETCs and this portability ensures that the receipt of funding will not cause any upward pressure on the high-cost fund.<sup>189</sup>

#### **IV. THERE IS STRONG SUPPORT IN THE RECORD FOR EXPANDING FUNDING FOR BROADBAND SERVICES BY INCLUDING BROADBAND AS A SUPPORTED SERVICE.**

A number of commenters agree with U.S. Cellular that the Commission should add broadband services to the list of supported services for universal service funding purposes because doing so will serve the interests of public health and safety in rural and high-cost areas and will also promote the continued growth and development of the national economy.<sup>190</sup>

TDS, for example, argues that “[t]he Commission should recognize the role broadband plays in rural areas and the increasing demand for broadband service, and make support for this advanced service explicit. This will help provide the proper incentives for further broadband deployment in rural areas that are lagging behind.”<sup>191</sup> Cellular South “welcomes the Joint Board’s recognition that broadband should be a supported service within the Universal Service Fund.

---

<sup>189</sup> See Section II.A.3.b., *supra*.

<sup>190</sup> U.S. Cellular Comments at 60-62.

<sup>191</sup> TDS Comments at 2. *But see* New Jersey BPU Comments at 9 (contending that, although the Board has long been a proponent of broadband deployment, “adding broadband to the list of federally supported services at this time would exacerbate the current problems with the high cost fund, particularly the size of the fund”). Even assuming that the future rate of high-cost fund growth may be problematic (a claim that U.S. Cellular disputes, see Section II.A.1.c., *supra*) U.S. Cellular has demonstrated that the Commission can realize substantial reductions in the level of high-cost fund disbursements by reforming funding mechanisms for rural incumbent LECs, especially by making their per-line support fully portable. See Section II.B.2., *supra*. These reductions could easily offset disbursements for broadband deployment, thus making it possible to achieve the Commission’s goals regarding broadband without threatening the sufficiency or sustainability of the fund.

This designation is long overdue and the Commission can speed broadband deployment to rural areas by declaring that broadband is a supported service.”<sup>192</sup>

An important statutory purpose is to ensure that universal service is *advanced* by the policies adopted by the Commission.<sup>193</sup> U.S. Cellular agrees with AT&T that, in furtherance of this statutory objective, there is “a clear desire on the part of many policy makers” to pursue “the goal of bringing advanced fixed and mobile broadband services to high-cost areas.”<sup>194</sup> As Commissioner Tate has observed, “broadband revolutionizes how we communicate, how, where and when we work, how we educate our children, the delivery of healthcare and public safety, as

---

<sup>192</sup> Cellular South Comments at 10. *See also* AARP Comments at 1; Centennial Comments at 8-9; CoBank Comments at 5-6; CU, CFA & FP Comments at 3; Indiana URC Comments at 5-6 (arguing that explicitly supporting broadband requires a change in the definition of supported services); New Jersey DRC Comments at 20 (supporting the proposal to “expand the definition of universal service to comport with the reality of today’s use of technology and telecommunications”); NTCA Comments at 8 (arguing that broadband should be treated as a supported service, and stating that “[t]he Commission needs to assist in the deployment of broadband through the use of USF support to make broadband affordable to consumers living in rural and high-cost areas”); Ohio PUC Comments at 7; TCA Comments at 11; TIA Comments at 5 (arguing that “[b]roadband support should extend beyond initial deployment in unserved areas, covering deployment in areas with little or no broadband service and the continued operation of existing broadband service”); WTA Comments at 5; WYOCA Comments on *Joint Board Comprehensive Reform NPRM* at 10 (indicating that it does not object to including broadband as a supported service, so long as (1) doing so would not adversely affect the provision of voice service; (2) appropriate levels of funding are made available; and (3) definitional issues are resolved regarding the qualification of broadband as a telecommunications service).

RICA expresses concern that there is not a basis for the Joint Board’s conclusion that a substantial majority of residential customers currently subscribe to broadband service. *See* RICA Comments at 7 (citing *Joint Board Comprehensive Reform NPRM*, 23 FCC Rcd at 1553 (para. 59)). RICA points out that this may be problematic because one of the statutory criteria for defining broadband as a supported service is that the service is subscribed to by a substantial majority of residential customers. *Id.*; *see* Section 254(c)(1)(B) of the Act. It may be possible for the Commission to conclude, however, that, even if a “substantial” majority of residential customers is not currently subscribing to broadband service, the agency still has discretion under Section 254(c) to establish broadband as a supported service. The other definitional criteria established in Section 254(c) are satisfied in the case of broadband, and growth trends with respect to broadband suggest that, if a substantial majority of residential customers currently is not subscribing, that threshold will be passed in the near future. Moreover, in light of the wide consensus that broadband is playing an increasingly important role in meeting consumers’ telecommunications needs, there is a strong basis for concluding that treating broadband as a supported service is consistent with the public interest, convenience, and necessity. *See* Section 254(c)(1)(D) of the Act. Because of these public interest considerations, the Commission should exercise its discretion to designate broadband as a supported service, concluding that the Act does not mandate that broadband must currently be subscribed to by a substantial majority of residential customers, but instead simply requires that the Commission treat the “substantial majority” criterion as one of several criteria to be considered by the agency.

<sup>193</sup> 47 U.S.C. § 254(b).

<sup>194</sup> AT&T Comments at 6.

well as how we entertain ourselves.”<sup>195</sup> Moreover, “[t]he Commission has consistently recognized the critical importance of broadband services to the nation’s present and future prosperity and is committed to adopting policies to promote the development of broadband services . . . .”<sup>196</sup>

The record reflects the fact that an important step in accomplishing the Commission’s goals is to include broadband as a supported service. Doing so will help ensure that technological advances that are changing the face of communications will be available to consumers in rural and other high-cost areas, enabling them to access all of the benefits and opportunities generated by these technological advances.<sup>197</sup>

## V. CONCLUSION.

U.S. Cellular urges the Commission to retain the identical support rule. The record does not support claims that the high-cost fund faces an imminent and catastrophic crisis that would warrant repeal of the rule. Elimination of the rule would not be consistent with statutory mandates or the principle of competitive neutrality, nor does the record lend any credence to claims that the rule deters efficient investment by wireless competitive ETCs or funds the operation of inefficient multiple wireless networks. Moreover, there is significant opposition in the record to the Commission’s proposal to replace the identical support rule with an embedded cost mechanism for wireless competitive ETCs.

Instead of terminating the identical support rule, the Commission should pursue more productive alternatives for ensuring the sufficiency and stability of the high-cost fund, including

---

<sup>195</sup> FCC Commissioner Deborah T. Tate, “Broadband to the Home: Broadband to America,” Broadband Properties Summit, Dallas, Texas, Apr. 30, 2008, at 3, accessed at <http://www.fcc.gov/commissioners/tate/speeches2008.html>.

<sup>196</sup> *Development of Nationwide Broadband Data To Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice Over Internet Protocol Subscribership*, WC Docket No. 07-38, *Notice of Proposed Rulemaking*, 22 FCC Rcd 7760 (para. 1) (2007), *quoted in Reverse Auctions NPRM*, 23 FCC Rcd at 1508-09 (para. 35).

<sup>197</sup> AARP, for example, argues that these benefits and opportunities are particularly important for older Americans. AARP Comments at i, 2-7.

review of the embedded cost methodology currently used to disburse funds to rural incumbent LECs and implementation of full portability of rural incumbent LEC per-line funding.

U.S. Cellular also requests the Commission to refrain from adopting any reverse auction mechanisms for the disbursement of high-cost funds, since these mechanisms would be anti-competitive and would have numerous other adverse effects.

Finally, U.S. Cellular encourages the Commission to define broadband as a service entitled to universal service support. Doing so is an important step in providing incentives for the further deployment of broadband services in rural and other high-cost areas.

Respectfully submitted,

UNITED STATES CELLULAR CORPORATION



David A. LaFuria  
Steven M. Chernoff

Lukas, Nace, Gutierrez & Sachs, Chartered  
1650 Tysons Boulevard, Suite 1500  
McLean, Virginia 22102  
(703) 584-8678

Grant Spellmeyer  
Director – Regulatory Affairs  
United States Cellular Corporation  
8410 West Bryn Mawr  
Chicago, Illinois 60631  
(773) 216-4045

June 2, 2008

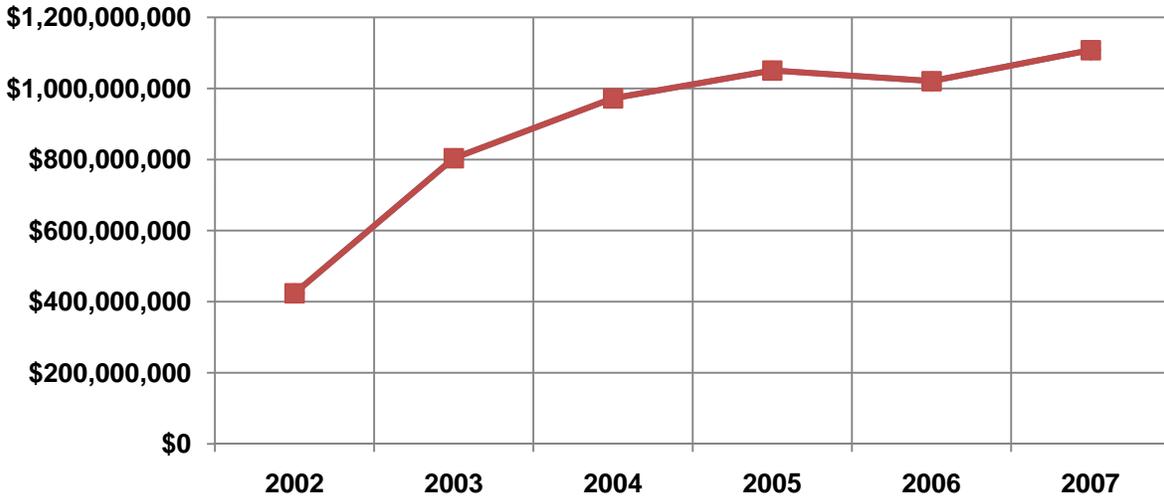
## **APPENDIX**

COMMENTS	SHORT TITLE
American Association of Retired Persons	AARP
Alexicon Telecommunications Consulting	Alexicon
Alltel Communications, LLC	Alltel
AT&T Inc.	AT&T
Alaska Telephone Association	ATA
Atlantic Tele-Network, Inc.	ATN
Cellular South, Inc.	Cellular South
Centennial Communications Corp.	Centennial
CenturyTel, Inc.	CenturyTel
Chinook Wireless	Chinook
CoBank, ACB	CoBank
Consumers Union, Consumer Federation of America, and Free Press	CU, CFA & FP
CTIA – The Wireless Association <sup>®</sup>	CTIA
Embarq	Embarq
Florida Public Service Commission	Florida PSC
General Communication, Inc.	GCI
GVNW Consulting, Inc.	GVNW
Independent Telephone and Telecommunications Alliance	ITTA
Indiana Utility Regulatory Commission	Indiana URC
Iowa Telecommunications Association	ITA
John Staurulakis, Inc.	JSI
Kansas Rural Independent Telephone Companies	KRITC
Mercatus Center	Mercatus
Missouri Small Telephone Company Group	MSTCG
National Consumer Law Center	NCLC
National Cable and Telecommunications Association	NCTA
National Exchange Carrier Association, Inc.	NECA
New Jersey Board of Public Utilities	New Jersey BPU
New Jersey Division of Rate Counsel	New Jersey DRC
New York Public Service Commission	New York PSC
North Dakota Public Service Commission	North Dakota PSC
National Telecommunications Cooperative Association	NTCA
Ohio Public Utility Commission	Ohio PUC
Oklahoma Corporation Commission	Oklahoma CC
Org. for the Promotion and Advancement of Small Telecom. Companies	OPASTCO
Qwest Communications International Inc.	Qwest
Rural Independent Competitive Alliance	RICA
Rural Telecommunications Associations (Colorado, Oregon, Washington)	RTA
Sprint Nextel Corporation	Sprint Nextel
Southeast Telephone, Inc. and Momentum Telecom, Inc.	ST & MT

COMMENTER	SHORT TITLE
Sacred Wind Communications, Inc.	SWC
TCA, Inc. - Telecom Consulting Associates	TCA
TDS Telecommunications Corporation	TDS
Telecommunications Industry Association	TIA
T-Mobile USA, Inc.	T-Mobile
TracFone Wireless, Inc.	TracFone
Utah Rural Telecom Association	URTA
USFon, Inc.	USFon
United States Telecom Association	USTA
Verizon and Verizon Wireless	Verizon
Virgin Islands Public Service Commission	Virgin Islands PSC
Windstream Communications, Inc.	Windstream
Western Telecommunications Alliance	WTA
Wyoming Office of Consumer Advocate	WYOCA

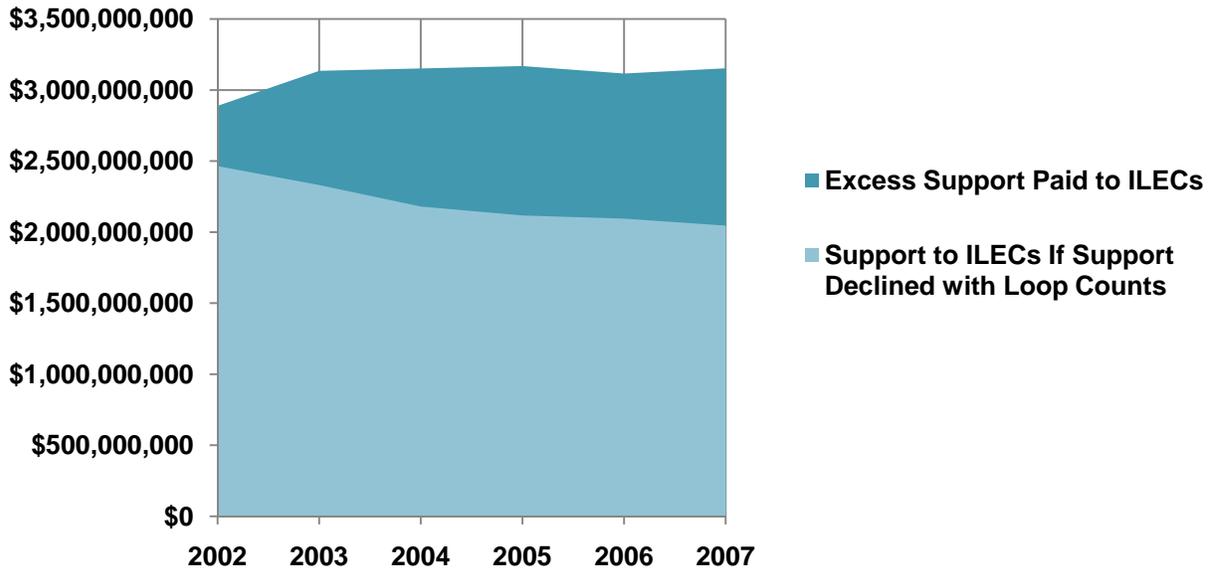
## **EXHIBIT 1**

### Amount of Potential Savings if ILEC Support Declined at Same Rate as Loop Counts

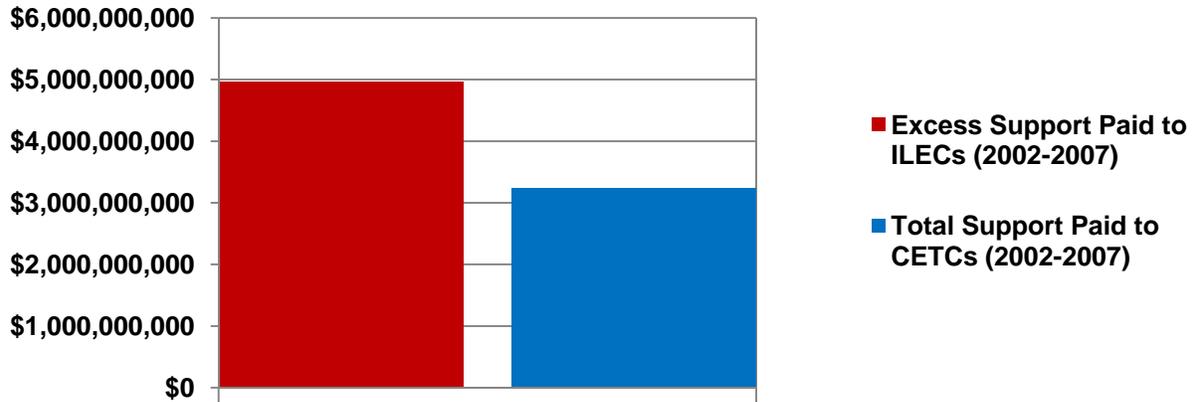


NOTE: Loop counts are as of June of each year, except for 2007 (December 2006 figures used)

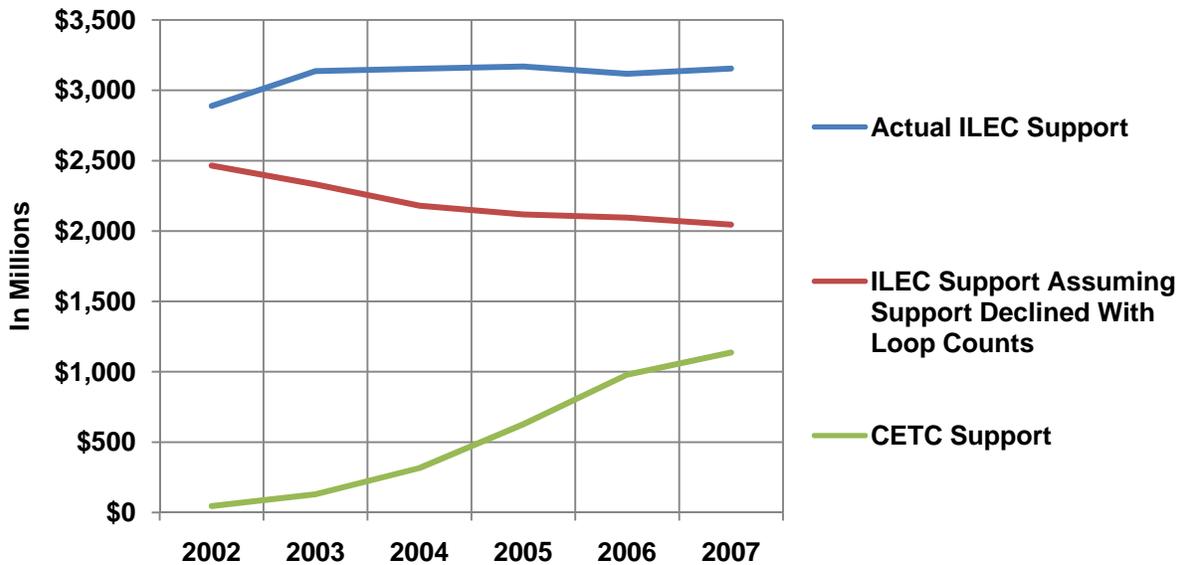
### Excess Support Received by ILECs Because Funding Did Not Account for Declines in Loop Counts



### Savings from Reduction of ILEC Support as Loop Counts Declined Would Have More Than Offset ALL Support to CETCs from 2002 to 2007



### Comparison of ILEC and CETC Support



NOTE: Loop counts are as of June of each year, except for 2007 (December 2006 figures used)

## **EXHIBIT 2**

# Universal Service Policy in the Competitive Telecommunications Era: The Advantages of Identical Support and The Disadvantages of Asymmetric Support

by

David E. M. Sappington<sup>1</sup>

## 1. Introduction.

Identical support payments to incumbent and competitive suppliers of telecommunications services have been a cornerstone of federal policy to promote universal service in the United States.<sup>2</sup> The Federal Communications Commission (“the Commission”) now proposes to replace identical support payments with cost-based asymmetric support payments.<sup>3</sup> Under the new proposed policy, each carrier that is eligible to receive high-cost support from the federal universal service fund would receive support that reflects its own cost of providing service. In particular, carriers would receive larger support payments as their measured costs increase. The abandonment of the identical support policy is intended to reduce the costs of promoting universal service in the United States. However, it may have just the opposite effect.

In contrast to identical support, cost-based asymmetric support provides poor incentives to industry participants, facilitates the operation of inefficient suppliers, and substitutes costly, imperfect regulatory micro-management for the discipline of competitive markets. An asymmetric

---

<sup>1</sup> David Sappington is the Lanzillotti-McKethan Eminent Scholar in the Department of Economics at the University of Florida. He is also the Director of the University’s Public Policy Research Center. Professor Sappington has served as the Federal Communications Commission’s Chief Economist, and presently serves as the President of the Industrial Organization Society.

<sup>2</sup> “Portable support” may be a more accurate term than “identical support” because universal service support is not identical on all dimensions for all suppliers at the present time. However, the term “identical support” will be employed in the ensuing discussion because this term is commonly employed in the ongoing debate about the best way to structure universal service policy in the United States.

<sup>3</sup> “[W]e tentatively conclude that we should eliminate the Commission’s current “identical support” rule ... which provides competitive ETCs with the same per-line high-cost universal service support amounts that incumbent local exchange carriers ... receive” (Federal Communications Commission, *In the Matter of High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, Notice of Proposed Rulemaking, WC Docket No. 05-337, CC Docket No. 96-45, Released January 29, 2008 (“*Asymmetric Support Notice*”), ¶1).

support policy thereby promotes higher industry costs, which can produce higher retail prices for basic telecommunications services as well as higher universal service support payments and contribution levels.

The Commission's proposal to abandon its carefully-crafted identical support policy reflects in part the belief that wireless and wireline telecommunications services are complements rather than substitutes, and so wireless and wireline suppliers do not compete against each other. The available evidence does not support this belief. Consequently, it is unwise to eschew the many benefits that an identical support policy can provide in today's – and tomorrow's – competitive telecommunications industry.

The purpose of the present analysis is to review the well-known merits of an identical support policy and to identify the corresponding drawbacks of a cost-based asymmetric support policy. The discussion proceeds as follows. Section 2 provides a brief review of the Commission's historic universal service policy, emphasizing the Commission's laudable decision to implement identical support. Section 3 reviews the many advantages of identical support in promoting universal service in a competitive telecommunications industry. Section 4 cites some of the many disadvantages of the cost-based asymmetric support policy that the Commission proposes, a policy that includes the asymmetric elimination of Interstate Access Support ("IAS") and Interstate Common Line Support ("ICLS") for competitive eligible telecommunications carriers ("ETCs").<sup>4</sup> Section 5 notes the Commission's rationale for asymmetric support, and explains why the rationale is not supported by the available evidence. Section 6 reiterates the important role of identical support in promoting universal service in the U.S. telecommunications industry.

## **2. The Commission's Historic Universal Service Policy.**

Section 254(b)(3) of the Telecommunications Act of 1996 ("the Act")<sup>5</sup> states that "Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services ... that

---

<sup>4</sup> The Commission states "We tentatively conclude that competitive ETCs should no longer receive Interstate Access Support (IAS) and Interstate Common Line Support (ICLS)" (*Asymmetric Support Notice*, ¶23).

<sup>5</sup> Pub. L. No. 104-104, §101(a), 110 Stat. 56 (codified at 47 U.S.C. §§ 151 *et. seq.*).

are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.” As the Conference Report on the Act makes clear, market-based deregulatory approaches to achieving this mandate are preferable to regulatory micro-management in today’s competitive telecommunications industry. The Conference Report describes the Act as intended “to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition.”<sup>6</sup>

To fulfill its universal service mandate prior to the development of substantial industry competition, the Commission undertook two main steps. First, it identified geographic regions of the country in which wireline telecommunications service was relatively costly to deliver. Second, the Commission provided financial support to the wireline suppliers that operated in the identified high-cost regions. The support delivered to a supplier increased as the supplier’s estimated cost of production increased. The support helped incumbent suppliers to operate profitably while charging prices for basic wireline services in high-cost regions that were reasonably comparable to the corresponding prices charged elsewhere in the country.

Competition from wireline and wireless carriers complicated the Commission’s high-cost support program. If support payments were delivered solely to incumbent wireline suppliers, the incumbents would be favored in their interaction with competitors. Such favoritism would create an unlevel playing field, making it difficult even for particularly efficient competitors to operate profitably in high-cost regions.

To help foster a level playing field for industry suppliers and thereby promote competitive neutrality,<sup>7</sup> the Commission implemented identical, portable per-line support. Specifically, if a customer in a high-cost region chose to secure service from a competitor rather than from the incumbent supplier, the support that the incumbent formerly received to serve the customer was

---

<sup>6</sup> United States House of Representative, 104<sup>th</sup> Congress, 2d Session, *Conference Report to Accompany S. 652*, Report 104-458, 1996.

<sup>7</sup> “[C]ompetitive neutrality means that universal service support mechanisms and rules neither unfairly advantage or disadvantage one provider over another, and neither unfairly favor or disfavor one technology over another” (*Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 at 8801 (1997), ¶47).

transferred to the competitor. Per-line support is portable under this policy because it accrues to the supplier that wins the customer's business. Per-line support also is identical under the policy because the same level of support is paid to the supplier that secures the customer's loyalty, regardless of the supplier's incumbency status or the technology it employs to serve the customer.

The Commission followed standard, widely-accepted principles when it instituted portable, identical support. Such support is essential to ensure a level playing field and competitive neutrality. If different levels of support were provided to different suppliers, a supplier that received less support than a rival might be unable to compete effectively for a customer's business. This is the case even if the supplier is the most efficient (i.e., the least cost) competitor. Despite its lower operating costs, the efficient supplier might be driven from the market by a less efficient, but more heavily subsidized, rival.<sup>8</sup>

As section 3 explains in detail, identical support helps to ensure that the most efficient supplier prevails in the marketplace. Identical support thereby ensures that industry production costs are minimized at any point in time. Furthermore, identical support continues to promote industry cost minimization over time as industry costs change, even if the level of support is not adjusted quickly to reflect changing costs.<sup>9</sup> Identical support also provides strong incentives for industry suppliers to work diligently to constantly minimize their operating costs.

Despite the many well-known merits of an identical support policy, the Commission proposes to eliminate identical support, in part by eliminating IAS and ICLS asymmetrically for competitive ETCs. According to the Commission, this proposed policy reversal reflects in part the fact that many customers presently choose to purchase both wireline and wireless telecommunications service. Consequently, high-cost support on behalf of these customers is being paid both to their wireline supplier and to their wireless supplier. As a result, the total amount of high-

---

<sup>8</sup> "A rational universal service policy minimizes distortions ... and has no impact on the competitive process" (Gregory L. Rosston and Bradley S. Wimmer, "The 'State' of Universal Service Policy," *Information Economics and Policy*, 12(3), September 2000 ["Rosston and Wimmer, 2000"], at 276).

<sup>9</sup> "The fast pace of technological change and the ability of firms to respond to incentives makes it very difficult, if not impossible, to develop rules that withstand the dynamics of the market" (Rosston and Wimmer, 2000, at 276). Identical support is unique in guaranteeing symmetric treatment and competitive neutrality as industry conditions change.

cost support paid to suppliers has increased substantially in recent years. Because this support is financed by contributions from consumers who purchase interstate telecommunications services, the increased support has increased the amount that these consumers must contribute.

In an attempt to limit these contributions by limiting high-cost support payments, the Commission proposes to link the high-cost support that any supplier receives to an estimate of the supplier's operating costs. In particular, the per-line support that a supplier will receive for serving a customer will increase as the supplier's estimated cost increases. In principle, this policy of asymmetric support could reduce total high-cost support payments in the short run. It could do so if competitors have lower costs than incumbent suppliers, and so per-line support payments to competitors will be reduced below the payments they presently receive, which reflect the estimated costs of incumbent suppliers. However, if competitors do indeed have lower costs than incumbent suppliers, then the Commission might be advised to consider carefully, as an element of comprehensive long-term reform, whether less efficient incumbent suppliers should be rewarded with higher subsidy payments.

Even if the proposed cost-based asymmetric support policy could reduce the short-term costs of promoting universal service, the policy threatens to increase corresponding long-term costs because of the policy's many drawbacks. The drawbacks are discussed in section 4, after section 3 reviews the primary merits of identical support policies.

### **3. The Merits of Identical Support.**

An identical support policy to promote universal service has many merits. Identical support secures a level playing field in the industry, and thereby limits the ability of less efficient suppliers to drive their more efficient rivals from the market. In doing so, identical support promotes industry cost minimization and corresponding low prices for consumers at any moment in time. Furthermore, even if the support payments are not updated continually as industry conditions change and as supplier capabilities vary, identical support continues to promote industry cost minimization.<sup>10</sup>

---

<sup>10</sup> Moreover, if the Commission determines that a high-cost area has effective competition, then support in the area might reflect the (relatively low) costs of the most efficient supplier. Such a policy can help

## **Identical Support Promotes the Success of the Most Efficient Suppliers**

To illustrate these more general conclusions, consider a simple, stylized setting in which an incumbent supplier can serve customers at a constant unit cost of 30 while a (more efficient) competitor can serve customers at a unit cost of 27. Suppose further that the incumbent supplier initially receives a support payment of 10 for each customer it serves while the competitor receives a smaller support payment of 5 for each customer it serves. In this setting, it is profitable for the incumbent supplier to serve customers at any price above 20, which is the supplier's effective unit cost of production after adjusting for the support payment it receives ( $30 - 10$ ). The competitor must receive a price above its support-adjusted effective unit cost of 22 ( $= 27 - 5$ ) in order to serve customers profitably. Therefore, by setting a price between 20 and 22 in this setting with asymmetric support, the incumbent supplier can preclude the profitable operation of the more efficient competitor.

In contrast, identical support would ensure that the more efficient supplier prevails in the marketplace in this setting. When the incumbent supplier and the competitor both receive the same support payment,  $s$ , for each customer they serve, the incumbent can serve customers profitably at any price above  $30 - s$  while the competitor can serve customers profitably at any price above  $27 - s$ .<sup>11</sup> Thus, identical support (at any level) ensures that a less efficient supplier is unable to drive a more efficient supplier from the market. Identical support thereby ensures that industry costs are minimized, which helps to secure low prices for consumers and to limit the support payments and contributions required to promote universal service.

## **Identical Support Promotes Cost Minimization Automatically as Conditions Change**

Even without continual updating, identical support ensures that industry costs are minimized as production costs change over time. Suppose, for example, that the incumbent supplier in the simple setting described above is able to reduce its unit cost to 25 while the competitor is only able to reduce its unit cost to 26. In this case, identical support will ensure that the more ef-

---

to reduce the consumer contributions required to ensure a level of support that is sufficient to achieve universal service objectives.

<sup>11</sup> For example, if the unit support payment  $s$  is 5, the incumbent supplier can serve customers profitably at any price above 25 ( $= 30 - 5$ ) while the competitor can serve customers profitably at any price above 22 ( $= 27 - 5$ ).

efficient incumbent supplier now prevails in the marketplace. With identical unit support  $s$ , the competitor must secure a price of at least  $26 - s$  in order to serve customers profitably, while the incumbent can operate profitably at any price above  $25 - s$ . Therefore, by setting a price between  $25 - s$  and  $26 - s$  (e.g., between 20 and 21 when  $s$  is 5), the incumbent can profitably attract customers from the less efficient rival.

### **Identical Support Provides Desirable Incentives**

Because identical support helps to ensure that the more efficient supplier prevails in the marketplace, identical support provides strong incentives for incumbent suppliers and competitors alike to constantly strive to reduce their operating costs. As long as the support payment to a supplier is not reduced as its costs decline, the supplier realizes the full value of any cost reduction it achieves. The cost reduction enables the supplier to compete more effectively against its rivals, allowing the supplier to increase its profit as it delivers lower prices to consumers.

In summary, by treating all suppliers symmetrically, identical support limits the ability of less efficient suppliers to drive more efficient rivals from the market. Identical support also maintains a level playing field and thereby promotes industry cost minimization over time as industry conditions change. In addition, identical support provides strong incentives to all industry suppliers to operate efficiently. By promoting ongoing industry cost minimization, identical support can both limit universal service support payments and contributions and facilitate low retail prices for consumers.

### **4. The Deficiencies of Asymmetric Support.**

In direct contrast to the many advantages of identical support, asymmetric support entails many disadvantages. The disadvantages are particularly pronounced when the asymmetric support reflects the measured costs of industry suppliers. Such asymmetric support can increase industry costs by limiting incentives for efficient operation. Asymmetric support in general can increase industry costs by allowing less efficient suppliers to drive more efficient rivals from the market. By facilitating higher industry costs, asymmetric support can harm consumers by promoting both higher universal service payments and contributions and higher retail prices for basic telecommunications services.

### **Asymmetric Support Provides Detrimental Incentives**

Any policy that delivers more support to a supplier as its realized costs increase subsidizes cost increases and penalizes cost reductions. Such a policy thereby diminishes incentives for cost reduction and efficient industry operation. The cost increases that such policies engender can harm consumers by promoting both higher prices for retail services and higher universal service support payments and associated contributions.

A policy that delivers more support as measured cost increases also creates incentives to exaggerate actual costs. Such incentives complicate the task of measuring costs accurately.

### **Asymmetric Support Can Increase Total Long-Term Universal Service Costs**

A policy of asymmetric support could conceivably reduce the short-term costs of promoting universal service, despite the detrimental incentives it creates. It could do so, for instance, if the operating costs of competitors presently are lower than the operating costs of incumbent suppliers. However, if this is the case, then it is not apparent why less efficient incumbent suppliers should be rewarded with higher subsidy levels.

Even if asymmetric support did provide short-term benefits, a policy that links support to realized costs can promote higher long-term universal service contributions and distributions in two distinct ways. First, competitors that are penalized with reduced support as their operating costs decline will have limited incentive to reduce their operating costs. Consequently, these costs and the associated higher level of universal service support payments and contributions may increase over time more rapidly than they would under an identical support policy.

Second, incumbent suppliers will have corresponding incentives to allow their operating costs to increase if the support they receive reflects their measured costs. Furthermore, competitors whose incentives for cost reduction are dulled by an asymmetric support policy may impose less competitive discipline on incumbent suppliers. This reduced discipline can limit incentives for efficient operation by incumbent suppliers, and thereby promote higher operating costs, and thus higher universal service payments and contributions.

## **Asymmetric Support Can Permit the Operation of Inefficient Suppliers**

Asymmetric support also can increase industry costs by facilitating the operation of inefficient suppliers. In contrast to identical support, asymmetric support can allow a less efficient supplier to drive a more efficient rival from the market.

This more general point was illustrated by the example in section 3 above. In that example, the incumbent supplier with unit cost 30 received a support payment of 10 while the competitor with unit cost 27 received a support payment of 5. In such a setting, the incumbent's effective unit cost after accounting for the support it receives is 20 ( $= 30 - 10$ ), while the competitor's effective after-support unit cost is 22 ( $= 27 - 5$ ). Therefore, even though the competitor is the more efficient operator, the incumbent supplier can profitably undercut any price that is profitable for the competitor (i.e., any price above 22). Consequently, the asymmetric support allows the incumbent to drive the more efficient competitor from the market.

The asymmetric support in this example might stem, for instance, from imperfect estimation of the operating costs of the incumbent supplier and/or the competitor. The incumbent's unit support might exceed the competitor's unit support by 5 because the competitor's unit cost advantage is estimated to be 5 even though it is truly only 3 ( $= 30 - 27$ ). Errors in cost estimation can promote the operation of inefficient suppliers under an asymmetric support policy.<sup>12</sup>

## **Asymmetric Support is Costly and Difficult to Implement**

The preceding example illustrates the important general point that, in contrast to an identical support policy, an asymmetric support policy requires precise, accurate assessments of the costs of every industry supplier. Without such assessments, some suppliers will either be unduly advantaged or disadvantaged, and the competitive process will be compromised. This is a fundamental limitation of any regulatory policy that attempts to micro-manage industry competition. Such regulatory micro-management is inherently impossible to implement precisely. Furthermore, the micro-management can be very costly to implement even in its unavoidably imperfect form. The Commission's *Asymmetric Support Notice* (¶¶13-19) identifies some of the many con-

---

<sup>12</sup> In contrast, as illustrated in section 3, a less efficient supplier generally will not be able to drive a more efficient rival from the market under an identical support policy. This is the case even if the identical support provided to all suppliers does not reflect a perfect estimate of the relevant costs of any supplier.

controversial issues that will need to be resolved in order to implement a cost-based asymmetric support policy. Resolution of these issues will be complex, costly, and unavoidably imperfect, raising the possibility that inefficient suppliers will thrive while efficient suppliers are driven from the market.

### **Asymmetric Support Requires Ongoing Regulatory Micro-Management**

As the example in section 3 illustrates, identical support helps to ensure that the most efficient supplier prevails in the market, even as industry conditions change and the capabilities of industry suppliers vary. Asymmetric support does not share this virtue. To understand why, return to the example in section 3, where the incumbent supplier's unit cost initially is 30 and the competitor's unit cost is 27. Suppose the regulator is somehow able to measure the supplier's costs perfectly in this setting. Further suppose the regulator awards the incumbent supplier a unit support payment of 10 and the competitor a unit support payment of 7 in order to ensure that they each can profitably serve customers at any price above 20.

Now suppose the incumbent supplier manages to reduce its unit cost to 29 while the competitor's unit cost remains unchanged at 27. If the regulator does not immediately observe the incumbent's cost reduction and reduce the incumbent's support payment commensurately, the less efficient incumbent supplier will be able to drive the more efficient competitor from the market. The incumbent can do so by charging a price between 19 and 20. This price is profitable for the incumbent supplier because its effective after-support unit cost is 19 ( $= 29 - 10$ ). However, the more efficient competitor cannot operate profitably at this price because its effective after-support unit cost is 20 ( $= 27 - 7$ ).

In this example and more generally, even perfect cost estimation at a given moment in time is not sufficient to prevent a less efficient supplier from driving a more efficient rival from the market under a cost-based asymmetric support policy. A regulator must be able to measure costs perfectly *continually* over time and adjust support payments immediately as costs change. This theoretical ideal is impossible to achieve in practice. Therefore, even the most thoughtfully

designed and carefully executed asymmetric support policy will be unable to ensure industry cost minimization in practice.<sup>13</sup>

In summary, cost-based asymmetric support policies entail many important disadvantages. These disadvantages foster higher industry costs which can harm consumers by increasing retail prices and by requiring consumers to make higher contributions to finance increased universal service support payments.

## **5. The Basis for the Commission’s Proposed Policy is Not Apparent.**

The advantages of identical support are particularly pronounced when industry suppliers compete to serve customers. The Commission appears willing to forego the many advantages of identical support and incur the many disadvantages of asymmetric support in part because it believes wireless and wireline suppliers are not engaged in direct competition. This belief appears to stem from the Commission’s view that “the majority of households do not view wireline and wireless services to be direct substitutes” (*Asymmetric Support Notice*, ¶10).

The Commission’s view about household preferences and thus its belief about industry competition appear to emanate from the observation that “only approximately 8 percent of U.S. households relied exclusively on wireless phones in 2005” (*Asymmetric Support Notice*, ¶9, n. 27). Thus, the Commission appears to suggest that because many consumers presently choose to purchase both wireline and wireless telecommunications service, they do not view the two services as substitutes, and so wireline and wireless suppliers are not competing to serve customers.

This line of thought is problematic in at least two important respects. First, even if few customers choose to “cut the cord” (i.e., purchase only wireless telecommunications service and no wireline service), they may still view wireless and wireline services as substitutes. Second,

---

<sup>13</sup> The Commission suggests that the asymmetric elimination of IAS and ICLS for competitive ETCs may be appropriate because, in contrast to incumbent suppliers, competitive ETCs “are not subject to [subscriber line charge] SLC caps” (*Asymmetric Support Notice*, ¶23). The underlying presumption seems to be that asymmetric elimination of IAS and ICLS for competitive ETCs will just offset any advantage they may enjoy because they do not face capped SLCs. The basis for this presumption is not apparent. Furthermore, in practice, it is virtually impossible to design an asymmetric support policy that exactly offsets the effects of other asymmetric regulations, even at a single moment in time. The futility of such an exercise is compounded in dynamic settings where industry conditions change over time. For the reasons identified above, consumers are better served when all industry producers are treated symmetrically and permitted to compete for customers on a level playing field.

the statistic that the Commission cites regarding the extent to which customers have cut the cord is dated. The statistic does not accurately describe current industry conditions. Furthermore, the statistic likely does not reflect future industry conditions, which are of paramount importance when designing a forward-looking, long-term universal service policy.

### **The Evidence Does Not Imply that Wireline and Wireless Services are Complements**

The Commission appears to conclude that because consumers purchase both wireless and wireline services, they necessarily view the two services as complements, not substitutes. This conclusion is incorrect. To understand why, consider the following simple example. Suppose that 92% of consumers purchase both wool sweaters and sweaters made from synthetic materials (“synthetic sweaters”) while 8% purchase only synthetic sweaters. Does this observed behavior imply that most consumers view wool sweaters and synthetic sweaters to be complements, and not substitutes? No, it does not. The observed purchasing behavior could well arise in a setting where all consumers view the two types of sweaters to be substitutes.<sup>14</sup>

Some consumers may like synthetic sweaters so much more than wool sweaters that they consistently purchase the former at prevailing prices. Most consumers, though, may derive comparable pleasure from the two types of sweaters, and so purchase both wool sweaters and synthetic sweaters at the prevailing prices. However, if the price of synthetic sweaters were to decrease and/or if the quality of synthetic sweaters were to increase relative to the price and quality of wool sweaters, many of the customers who presently purchase both types of sweaters might decide to purchase only synthetic sweaters. In such a setting, consumers view wool sweaters and synthetic sweaters to be substitutes even though they presently purchase both types of sweaters.

The same likely is true of wireline and wireless telecommunications services. Some consumers may find the mobility that wireless service provides to be so indispensable that they purchase only wireless service. The majority of consumers, though, may value the key attributes of the two types of service more symmetrically, and so choose to purchase both services at current

---

<sup>14</sup> Formally, two services are substitutes if their cross-price elasticity of demand is positive (Robert Pindyck and Daniel Rubinfeld, *Microeconomics*, Fourth Edition, Prentice Hall, 1998, p. 34). In other words, services A and B are substitutes from a consumer’s perspective if the consumer buys more of service A when the price of service B increases and more of service B when the price of service A increases, *ceteris paribus*.

prices. This is not to say, though, that the majority of consumers view wireline and wireless services to be complements. If the price of wireless service were to decrease significantly and/or if the quality of wireless service were to increase significantly in rural areas,<sup>15</sup> many more customers, including rural customers, might choose to purchase only wireless service. Therefore, the purchasing pattern noted by the Commission does not imply that consumers necessarily view wireline and wireless services to be complements rather than substitutes.

### **Many Consumers are Cutting the Cord**

The Commission appears to believe that the extent to which consumers are cutting the cord is a measure of both the extent to which consumers view wireless and wireline services as substitutes and the intensity of competition between the suppliers of these two services. If this belief is correct, then recent consumer behavior supports the conclusion that competition between wireless and wireline suppliers has increased substantially in recent years, and so the many benefits of identical support have become particularly germane. Consumers have been cutting the cord at an increasing rate in recent years. The U.S. Department of Health and Human Services reports that 13.6% of U.S. households had cut the cord by the first half of 2007, an increase of more than 50% in less than two years.<sup>16</sup>

Many expect this pronounced trend to continue.<sup>17</sup> Morgan Stanley, for example, estimates that 32% of U.S. households will have cut the cord by 2012.<sup>18</sup> Morgan Stanley also notes that an

---

<sup>15</sup> The perceived quality of wireless service might be improved, for example, by devices that facilitate the operation of wireless phones on home wi-fi networks and/or by femtocells, which amplify cellular and PCS signals within the home (Steve G. Parsons, *The New Communications Paradigm: Implications for Universal Service*, Exhibit 3 in *Alltel Reply Comments in the Matter of High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, July 2, 2007).

<sup>16</sup> U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Health Statistics, *Wireless Substitution: Early Release of Estimates Based on Data from the National Health Interview Survey*, January-July 2007 (released December 10, 2007).

<sup>17</sup> Of course, the rate at which consumers actually cut the cord will be influenced by regulatory policy. For example, if incumbent wireline suppliers are afforded greater support than wireless providers, the former may be able to keep their prices relatively low and thereby limit the rate at which consumers cut the cord. In contrast, identical support could foster a reduction in the relative price of wireless service, which could increase the rate at which consumers cut the cord.

<sup>18</sup> Morgan Stanley, *Telecom Services, Cutting the Cord: Wireless Substitution is Accelerating*, September 27, 2007 (“*Morgan Stanley Report*”), p. 1.

even larger percentage of households have already cut the cord in some European countries.<sup>19</sup> Thus, the projected trend in the U.S. is consistent with experience elsewhere in the world.

It is also important to note that low-income households are cutting the cord at a more rapid rate than other households. As the U.S. Department of Health and Human Services observes, “Adults living in poverty (21.6%) were more likely than higher income adults to be living in households with only wireless telephones” in 2007 (p. 3).<sup>20</sup>

If an increased incidence of cutting the cord constitutes stronger evidence that consumers view wireline and wireless services to be substitutes, then the data suggest that low-income households – the households for which universal service policies likely are most crucial – are particularly likely to view wireline and wireless services as substitutes. Consequently, the many advantages of identical support in promoting universal service may be particularly valuable for the individuals that are likely to benefit the most from universal service policies.

In summary, the many advantages of identical support in promoting universal service would be germane even if a large number of households had not cut the cord and even if they were not expected to cut the cord in the near future. However, more and more U.S. households have been cutting the cord in recent years. This trend is particularly notable among low-income households. Thus, many consumers – low-income consumers in particular – would be denied the important benefits of identical support if this cornerstone of the Commission’s universal service policy in the presence of market competition were to be abandoned.

## **6. Conclusions.**

Identical support has been a cornerstone of the Commission’s policy to promote universal service in the U.S. telecommunications industry. The well-crafted identical support policy harnesses the proven discipline of market competition to benefit consumers by fostering industry cost minimization.

---

<sup>19</sup> 33% of homes are already wireless-only in Austria (*Morgan Stanley Report*, p. 5).

<sup>20</sup> The *Morgan Stanley Report* (p. 10) also notes that “Wireless-only households are a growing trend among lower-income households.”

The Commission now proposes to eschew the many well-known advantages of an identical support policy by implementing a cost-based asymmetric support policy that includes the asymmetric elimination of IAS and ICLS for competitive ETCs. The proposed policy would substitute unavoidably imperfect regulatory micro-management for competitive discipline, in contrast to the stated intent of the Act. The proposed policy would reward inefficient high-cost suppliers, punish efficient low-cost suppliers, and even allow inefficient suppliers to drive more efficient rivals from the market. In doing so, the policy would limit incentives for cost minimization and efficient operation, and thereby promote higher industry costs. The higher costs, in turn, would harm consumers in the long run by promoting both higher retail prices and higher universal service support payments and contributions.

The Commission suggests that the proposed policy change is needed in part because consumers view wireless and wireline services as complements, not substitutes. The available evidence does not support this conclusion. Furthermore, far more households – especially low-income households – have cut the cord than the dated evidence cited by the Commission would suggest. Substantially more households are projected to cut the cord in the near future. Long-term policies like the Commission’s universal service policy must be designed to reflect future – not historic – industry trends and conditions.

The Commission’s proposed change in policy is intended to reduce the costs of promoting universal service. It is conceivable that the change might reduce short-term costs if competitors are able to provide relevant services at lower cost than incumbent suppliers. Of course, if this is the case, then one wonders why inefficient incumbent suppliers would continue to be paid to provide a service that competitors can supply at lower cost.

The Commission states that it “must fundamentally reform how we distribute support under the existing high-cost mechanism” (*Asymmetric Support Notice*, ¶5). Such fundamental reform may indeed be warranted. However, to be successful, any reform must be tailored to the environment in which it is implemented. In today’s competitive telecommunications industry, reform should harness the proven discipline of market competition rather than replace this discipline with more extensive and unavoidably imperfect regulatory micro-management.