MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress
www.freepress.net

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

October 24, 2008

Re: Notice of Written *Ex Parte* Presentation (WC Docket 05-337; CC Docket 96-45; WC Docket 06-122; CC Docket 01-92)

Dear Ms. Dortch,

Free Press submits this written *ex parte* filing to update the record on particular issues in the Commission's open dockets on Developing a Unified Intercarrier Compensation Regime (CC Docket No. 01-92), and related Universal Service Fund (USF) dockets (WC Docket No. 05-337 and CC Docket No. 96-45).

In this *ex parte* we provide our analysis and recommendations on the draft ICC-USF reform proposal ("Draft Proposal") currently scheduled for a full Commission vote on November 4th. We first outline the Draft Proposal (as we understand it), then offer recommendations on how to modify and implement this plan in a manner that is fair, efficient, reasonable, and consumer friendly.

Ultimately, with our recommendations incorporated, we feel that the Commission can and should adopt both a Report and Order *and* a Further Notice of Proposed Rulemaking at the November 4th open meeting. We recommend that the Report and Order establish a solid framework for transitioning the ICC system to cost-based rates and establish a solid framework for incorporating broadband into the USF. The Further Notice should then deal with most of the implementation details of these frameworks (and do so in a three to six month comment cycle with three to six additional months to move to a final Order). While there is general consensus in the record that ICC rates should be lowered and that USF must be modernized, the implementation details that achieve these outcomes are what causes much of the dispute. A Report and Order with a solid transition framework and a Further Notice with firm tentative conclusions will move this debate beyond the current impasse while still addressing many of the concerns of the commenters who would rather the Commission delay this entire matter.

Bifurcation of Commission action on November 4th into these two items recognizes that even if every element of the policy were to be contained in a single Order, the administrative mechanisms needed to implement the Order and transition the regulatory regimes would take time and further input to devise and settle. An Order will delimit the start and end points of reform, establishes the first steps, and chart a clear path forward—while an FNPRM opens an opportunity for further deliberation on the means.

Our primary interest in these proceedings is to ensure consumers are treated fairly and not unduly burdened. We want to make certain that consumers, not just particular private companies, benefit from these reforms. With the appropriate changes made to the Draft Proposal, the Commission can usher in long-overdue reforms that are equitable, minimize consumer burden, increase efficiency, and bring affordable high-quality broadband to every region of the nation.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress
www.freepress.net

The Commission's Draft ICC-USF Reform Proposal

The draft ICC-USF reform proposal on circulation at the Commission is designed to achieve two important policy objectives: reforming the system of intercarrier compensation (albeit only on the terminating side) and modernizing the Universal Service Fund. Our understanding of the elements of the Draft Proposal is based on our conversations with the Chairman's office on October 17, 2008, and on various media reports and analyst statements.[1] Trying to glean the details of such a comprehensive proposal in this fashion is far from ideal. However, we recognize that most of the ideas on the table are present in the record in some form. Based on what we do know, the proposal needs further modifications in order to adequately achieve the policy objectives in a manner that is consistent with the public interest principles of the Communications Act.

ICC Reform Elements of the Commission's Draft Proposal

The Commission proposes a 10-year phase down of all terminating access rates to a unified reciprocal compensation rate within each state, set by state regulators. In the first two years of the 10-year path, intrastate rates are lowered to interstate levels. In the fifth year, the states will have set a rate that is close to reciprocal compensation levels (RC). By the end of the 10-year process, all rates within each state must be uniform, at a level of forward-looking reciprocal compensation.

This lowering of terminating access charges will result in a reduction in revenues for those companies who are current net recipients of access fees -- local exchange carriers (though we should note here that access minutes will likely continue to decline as the rates are phased down, an aspect we comment on in detail below). In order to "offset" this decline in revenue, the Commission proposes to raise the Federal Subscriber Line Charge (SLC) for primary residential and single-line businesses by $1.50, to a total of $8.00 per month. The multi-line business SLC will increase to $11.50 per month. These increases will come as the Federal-State Joint Board is tasked with the determining an appropriate national rate benchmark, and deciding whether further SLC increases will be allowed.

Since there is a widely-held belief that above-cost access charges are an implicit subsidy for universal service, the Commission's Draft Proposal also offers a recovery mechanism for certain carriers operating in high-cost areas. Rate-of-Return (RoR) carriers operating in these areas will be able to access increased universal service support from the interstate common line support program (ICLS). The Commission estimates that this will amount to $500 million in total additional funds over the entire first 5-year period, and will be approximately $200 million to $300 million in each year following. We do not know if this additional funding is capped, or remains uncapped like the current ICLS funds. We also do not know the details on how the amount of support for each carrier is calculated (i.e. whether or not it is based on forward-looking costs, or embedded costs as

[1] *See* Ex Parte communication of Free Press, WC Docket 05-337; CC Docket 96-45; WC Docket 06 122; CC Docket 01-92, October 20, 2008; *see also e.g.*, Joelle Tessler, "FCC chair eyes fallow TV airwaves for broadband", *Associated Press*, October 15, 2008. Therefore, we alone are responsible for the characterization of the Commission's Draft Proposal in this *ex parte*, and make no claims as to the accuracy of our characterization, since we have never actually seen the circulated draft.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress
www.freepress.net

currently calculated for ICLS). Under the Draft Proposal, price-cap (PC) regulated carriers will not be able to obtain any access recovery funds (ARF) unless they petition the Commission and show their costs. It is unclear to us whether this cost-showing process will rely solely on the regulated cost-structure of a carrier's business, or if it considers all revenue and costs (e.g. broadband, IPTV, directory services, etc...)

We understand the Draft Proposal will deal with the issue of phantom traffic by requiring that all providers identify their traffic, or face the possibility of being charged the highest possible access rate.

We also understand that voice-over-Internet-protocol (VoIP) traffic will be classified as an information service. This change in policy has substantial implications for the ability of VoIP providers to obtain reasonable interconnection arrangements with other carriers. This move would likely increase the level of uncertainty in the access charge regime precisely at a time when the Commission is seeking to provide certainty. By declaring VoIP an information service, the structure of Section 251 and the entire industrial interconnection regime is called into question. This is a very dangerous move, as there is no parallel regime under Title I to ensure competitive access. This element of the reform package ***must*** be reviewed in a Further Notice to prevent substantial unintended consequences.

USF Reform Elements of the Commission's Draft Proposal

The Commission's Draft Proposal aims to reform the Federal Universal Service Fund (USF) by making fundamental changes to the contribution methodology, and requiring the offering of broadband service as a condition for USF support.

First, the Commission proposes to move the contributions system away from reliance on interstate telecommunications revenues to a numbers-based assessment. As we understand it, there will be a flat $1 per month fee assessed on all assigned telephone numbers, exempting pre-paid wireless numbers and Lifeline program numbers, but no exemption for additional "family-plan" numbers. According to NRUF, this amounts to nearly 617 million numbers.[2] At a $1 per month per number, this equates to about $7.4 billion per year, or approximately $100 million short of the 2008 projected total size of the Fund. Because of this and likely future shortfalls, the Commission's Draft Proposal will place some revenue-based assessment on businesses. The Commission believes that under this methodology the consumer's USF burden will decrease from approximately 48 percent of the fund to 42 percent of the fund.

On the distributions side, the Commission's Draft Proposal will freeze High Cost Fund support at the current level for each study area. The Commission will eliminate the Identical Support Rule (see below). The Commission's proposal will require that all USF-supported providers offer broadband to 100 percent of customers in their service areas within 5-years, with broadband defined

[2] "Numbering Resource Utilization in the United States, NRUF data as of December 31, 2007", Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission, August 2008.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress
www.freepress.net

as a service capable of providing a 768 kilobit per second (kbps) or higher connection in one-direction. Carriers are obligated to cover at least 20 percent of their unserved territory in the first year, and an additional 20 percent in each of years 2-5 (leading to 100 percent at the end of year five).

If a carrier is unable to meet these obligations at the current level of study-area level support, then the study area is put up for a reverse auction, with the reserve price being the current level of support. Bidders who participate in the reverse auction will be first ranked by the speed of their proposed broadband service, then by the level of their bid (i.e. broadband speed is given priority over the bid price). If a winning bidder is a new entrant, they will not be under the same buildout timeline as the incumbent. We are uncertain as to the length in time between reverse auctions, or if there will be future auctions at all for a given study area.

If no entity bids to offer support, then the study area is declared unserved. We understand that in this situation, the current carrier of last resort (COLR) for an un-bid study area will maintain their current level of High Cost support and will not be under any broadband obligations for that study area.

The Commission's Draft Proposal also creates a $300 per year Broadband Low-Income pilot project. We are uncertain as to how this program will be administered, but we believe it is intended to lower the cost of residential broadband for qualifying participants to the same price as lifeline-supported telephony service.

Finally, we understand that while the Commission's Draft Proposal eliminates the current Identical Support Rule, it does not envision a one-supported-provider per study area approach. The proposal caps the level of wireless CETC support at $1.25 billion per year (the estimated current level), but requires all CETCs to file cost studies to determine if they qualify for support. Support will only be provided if a CETCs costs exceeds a national benchmark (we believe in the Draft Proposal this is established as the average cost per line benchmark of approximately 135 percent).[3] We are uncertain as to the details of the process for a CETC to file cost information.

If in a given study are no wireless CETC agrees to make a cost-showing, then that study area undergoes a mobility reverse auction with the reserve price set at the lowest total amount of support given to a CETC in a particular study area.[4] CETCs would still have the same broadband obligations as incumbents.

Ultimately, it is assumed that the total amount of money going to wireless CETCs will be reduced substantially, and these funds redirected to meet the increased obligations on ICLS due to the changes in ICC.

---

[3] We are actually unsure if this was the benchmark (i.e. the *Ninth Order* benchmark) or if it was the 138 percent national urban rate benchmark established in the 2003 *Order on Remand*, or some other benchmark entirely.

[4] We are uncertain about this particular aspect, since under the Identical Support Rule, per-line support is identical across CETCs in a given study area. However, it could be that since each ETC serves a different amount of customers, the reserve price to serve the entire area would be set at the least total amount of support among current CETCs (i.e. the amount going to the CETC with the fewest amount of customers), with the winner required to offer service to any requesting customer within the study area.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress
www.freepress.net

Free Press' Assessment of and Recommendations to Improve
The Commission's Draft ICC-USF Reform Proposal

Below we offer our opinions on the Commission's Draft Proposal and recommendations for improving the plan in a manner that is consistent with the public interest principles of the Communications Act. We must stress that the recommendations we offer here are bound by the framework of the current Draft Proposal. That is, were we starting from scratch and working in a world free of path-dependency, we would likely offer a substantially different-looking package of reform policies. However, it is clear that idealism is not a luxury we can afford at this point. We are choosing to participate constructively in this process in an effort to minimize the burden that this reform package will place on consumers, and to ensure that these policy changes result in substantial long-term benefits for all consumers.

Improving the ICC Reform Elements of
The Commission's Draft Proposal: Terminating Access Rates

At its core, the ICC reform elements of the Commission's Draft Proposal results in a very-low terminating access rate that is uniform among all carriers within a given state. We fully support the notion that the price of terminating a call should not differ based solely on the arbitrary regulatory classification of the carriers involved in the transaction, nor should it differ based on the calls geographic origin.

However, this does not mean that we should throw the cost-based principles of the Act out the window. If a proper forward-looking cost study demonstrates a real difference in call termination cost between certain exchanges, then a unified rate across all calls fails to adhere to the cost-based principles of Section 252 and is economically inefficient. However, it may be the case that the transaction costs associated with a varying (but cost-based) rate structure exceed the efficiency gains from having cost-based rates. It is plausible that a unified rate structure reduces transaction costs and discourages arbitrage opportunities at a level that outweighs the efficiency losses and equity concerns of a unified rate. This is a central question that must be addressed.

Thus, we recommend that the Commission establish a framework that drives terminating access rates lower, but relies on the states to decide the issue of where the final rates should land. Thus, working within the structure of the current Draft Proposal, state regulators would establish a process where rates would decline in years 1 and 2 to the current interstate level; in years 3, 4 and 5 they would decline further to a carrier-specific, cost-based reciprocal compensation rate. The states would then decide whether or not to move to a unified forward-looking reciprocal compensation rate across all carries over the following 5-year period. We envision that in the November 4th Report and Order, the Commission puts a firm rule on the years 1 and 2 process, and seeks input on the implementation for years 3-10.

This approach to shaping the path to lower rates should address many of the concerns of the non-RBOC carriers, who don't dispute the need for a lower rate, but are opposed to a uniform $0.0007 rate.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress www.freepress.net

Improving the ICC Reform Elements of
The Commission's Draft Proposal: Subscriber Line Charge Increases

A central feature of the Commission's Draft Proposal is a $1.50 increase in the Subscriber Line Charge (SLC), to a maximum of $8.00 per primary residential line, and to $11.50 for business lines. The Commission has the statutory authority to impose Subscriber Line Charges to recover the portion of loop costs placed in the interstate jurisdiction. Thus, in the Draft Proposal, we have increases in the SLC designed to offset reductions in all terminating access charges -- both inter- and intrastate.[5]

SLCs are appropriate if they do not result in an over-recovery of costs. However, we are concerned that the current SLCs charged by carriers already result in an over-recovery of costs on a substantial portion of lines, and any further increases -- while offsetting access charge reductions -- could result in an even greater level of over-recovery. When the Commission adopted the current $6.50 SLC cap in the *CALLS Order*[6] it ruled that a further cost review proceeding would have to be undertaken in order to determine if SLCs should rise above $5.00. Specifically, the Commission stated that in this cost review proceeding it would "examine, forward-looking cost information associated with the provision of retail voice grade access to the public switched telephone network."[7] When the review proceeding was concluded, it became apparent that very little verifiable actual forward-looking cost information had been submitted to the Commission.[8] In the June 2002 *Order*, the Commission ruled that the $6.50 cap was reasonable, despite the conclusion that approximately 82 percent of residential and single-line business price-cap lines had forward-looking costs below $6.50.[9]

Therefore, we would prefer that the Commission revisit this issue in a comprehensive manner prior to implementing any SLC increases. However, we recognize the high likelihood of the Commission acting as it did in the *CALLS Order*, where it ordered an immediate SLC increase. If the

---

5 Because of this, the Commission must be explicit as to why this particular SLC increase is allowed under current law. *See* 47 U.S.C. §§ 4(i), 201-205; see also *National Association of Regulatory Utility Commissioners v. Federal Communications Commission*, 737 F.2d 1095, 1114 (D.C. Cir. 1984) (NARUC v. FCC).

6 *Access Charge Reform*, 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 (2000) (*CALLS Order*), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied, Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 70 U.S.L.W. 3444 (U.S. Apr. 15, 2002).

7 *Ibid.* ¶ 83

8 In his dissenting statement, Commissioner Michael J. Copps stated, "[a] significant number of carriers, however, submitted summary data without disclosing the inputs used, cost models that were not transparent, or in some cases, models that have been rejected by the state commissions... The Commission then failed to conduct its own independent analysis of the cost data. By failing to undertake the thorough analysis of cost data that was promised in the access reform order, we are neglecting our obligation to consumers."

9 See footnote 82, *In the Matter of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, FCC 02-161, rel. June 5, 2002.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress
www.freepress.net

Commission is determined to act in this fashion, we have several recommendations that will mitigate consumer harm.

First, given that the Draft Proposal calls for a phase in of access rate reductions, there should be a commensurate phase in of SLC increases. There is absolutely no reason why LECs should be permitted on day one to charge a full $1.50 in additional SLCs when they have not experienced *any* declines in access revenues. If the Commission is adamant that a $1.50 SLC increase is appropriate while the Federal-State Joint Board (FSJB) considers the issue of a national rate benchmark, then the Commission needs to provide some justification of how this $1.50 increase relates to reduced access charges, and phase in the SLC increase commensurate with the access charge decreases.

For example, in a recent *ex parte*, AT&T provides some estimates of the potential access shifts resulting from a move to a "recip comp proxy" to be $2.3 billion per year.[10] They also estimate that there are 81 million primary residential lines. Thus, under this scenario a SLC increase of $1.50 results in an offset of $1.46 billion annually from primary residential lines alone (we can also assume a substantial additional offset revenues from the increase in the multi-line business SLC from $9.20 to $11.50 -- perhaps as much as $1.1 billion annually).[11] But the full force of the $2.3 billion in annual access revenue reductions resulting from a decline to a "recip comp proxy" won't even be felt for many years -- potentially 10 years.

Why then should SLCs increase now? Plainly, they shouldn't. If they do, it should be very little while the access charges are phased down. Thus for example, if the phase down of access charges in year one results in a $500 million annual access shift, then the SLC increase for primary residential and single-line businesses should be no more than 25 cents.[12]

Therefore we request that in addition to delegating to the FSJB the issue of determining a national rate benchmark and final SLC cap, that the Commission, in the forthcoming Report and Order and Further Notice, begin a cost-review proceeding to determine the proper level for SLCs, based on forward-looking cost models that are detailed and transparent (and available for public review under cover of confidentiality).

We also strongly recommend that the Commission determine the net access shift that will result from a reduction in access rates to interstate levels by the end of year two of the ICC transition plan. We then recommend the Commission calculate the appropriate temporary SLC increase (for these

---

[10] *Ex Parte* communication of AT&T, Re: *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Universal Service Contribution Mechanism*, WC Docket No. 06-122; *Intercarrier Compensation for ISP-Bound Traffic*, WC Docket 99-68; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, October 20, 2008.

[11] The Commission estimates there were about 40 million multi-line business lines that companies reported as qualified to receive Subscriber Line Charges in 2006, and another 9.7 non-primary residential lines. See Table 1.3 in "Trends in Telephone Service", Industry Analysis Division, August 2008.

[12] Here we assume 86 million SLC-qualified primary residential and single line business lines, 9 million non-primary residential lines, and 40 million multi-line business access lines. Based on the current ratios of the residential-to-multi-line SLCs ($6.50/$9.20 = 0.7), the increase in the multi-line business SLC under this scenario would be about 40 cents per month.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

two years) based on this amount of access revenue shift (minus any imputed to vertically integrated LECs; see below) -- and that this SLC increase be itself phased in over the two year period. The Commission ***must*** approach the initial SLC increases in this fashion, for if it does not it is harming consumers by saddling them with plainly unjustifiable SLC increases. This method of parallel phase-in (access charges declining as SLC charges increase) represents a fair and reasonable way to ensure that the burden of regulatory change is shared and not borne disproportionately by rate-payers.

Our second recommendation is based upon the principle of fairness. We feel that the Commission must recognize the massive changes that have occurred in the telephony industry since it last undertook access charge reform in 2001. Since then, vertical integration between RBOCs, IXCs and wireless carriers has nearly reconstituted the former Ma Bell monopoly. Verizon and AT&T dominate the local exchange, long-distance and mobility markets. Their respective long-distance and wireless businesses will benefit substantially from the lowering of access charges. While it is true that the LEC side of their businesses will have declines in access revenues, it is a safe assumption (based on their eagerness for the Commission to lower access rates) that they stand to reap substantial net benefits from ICC reform.

Therefore we strongly urge the Commission to only allow a carrier to increase their SLCs if they can show their business experiences a net decline in revenues as a result of ICC reforms. Thus, wireline customers of AT&T and Verizon should not be subjected to SLC increases unless those carriers are able to demonstrate net access revenue declines as well as rates that are below the benchmark set by the FSJB. In the event of such a showing, the increases should proceed on the parallel phase-in method described above.

Improving the ICC Reform Elements of
The Commission's Draft Proposal: Access Recovery from USF

The other major feature of the Commission's Draft Proposal -- and most other ICC reform proposals -- is an Access Recovery Fund (ARF) for carriers who do not recover all of their revenue declines in increased SLCs. The reasoning here is that access charges contain an implicit universal service subsidy for high-cost carriers. However, there is no evidence whatsoever that the amount in ARF needed to "make a carrier whole" is in any way related to the amount of implicit USF support contained in access revenues. Therefore we are strongly opposed to any reform proposal that attempts to play a zero-sum-game.

The Commission must be guided by the Act. Universal service support should be explicit, and sufficient enough to ensure reasonably comparable rates. It should not be excessive. In this light, we remind the Commission of the wild range various parties attributed to the implicit USF component of price cap carrier interstate access charges in the CALLS proceeding. Some claimed the amount was as high as $3.9 billion annually, while others claimed a low of $250 million. The Commission ultimately settled on a value of $650 million -- a number suggested by industry and not calculated by the Commission. This pool of Interstate Access Support (IAS) was due to be reevaluated after 5 years, with acknowledgement that the $650 million amount might be excessive

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

after that time.[13] This never happened, despite the fact that interstate access minutes have declined some 40 percent since then, and despite the fact that technology costs have continued to decline.

The Commission's Draft Proposal would establish an ARF for rate of return carriers that would amount to a maximum of $200 million to $300 million per year. This pool of funds would be incorporated into the current program to offset reductions in interstate rates paid to rate-of-return carriers -- the Interstate Common Line Support program (ICLS). It is not clear to us what this $300 million in increased ICLS ARF is based upon. If it is the total amount that rate-of-return carriers will need to be "made whole" after a SLC increase, then it is an inappropriate deviation from the cost-based and sufficiency principles of the Act.

Under the Commission's Draft Proposal, price-cap regulated carriers will not be able to access this pool of money without first making a cost-showing (though we're uncertain as to how this would actually be structured; e.g. would a carrier have to "open the books" on all revenue and cost streams, or merely on the regulated side of the business). We support this approach, and believe it should apply to all carriers, including rate-of-return carriers. However, we understand the concerns the Commission has in regards to triggering potential confiscation claims by rate-of-return regulated carriers (though we still feel a cost-showing is appropriate in all cases).

Because the increased ICLS ARF will not be made available to price-cap carriers, the Commission must be cognizant of how this will impact these businesses. A quick look at the bottom line net profit margins (NPM) and Return on Equity (RE) of several major mid-size price cap carriers (i.e. non-vertically integrated RBOCs) reveals that most of these companies are already fairing better than the average for this industry sector (which is approximately 9.6 percent NPM over the past 5-years and a 11.9 percent RE over that time). Take for example the carrier Windstream. Their 5-year average NPM is above 17 percent, nearly two times the industry sector average. Windstream's 5-year average Return on Equity is 50.2 percent, nearly five times the industry sector average. At the other extreme is a company like Fairpoint Communications, whose 5-year average NPM is 2.5 percent, with a 5-year average RE of 16 percent. Also worth noting is the fact that many of these carriers have long-distance business segments that stand to reap substantial access charge savings.

Since many of the price cap regulated companies earn returns far higher than the 11.25 percent for rate-of-return carriers, is it fair for USF funds to be awarded to these companies to offset revenue losses from reductions in above-cost access charges -- revenues that are in a natural free fall as a result of changing market conditions? Is it fair for these USF funds to be locked in and awarded in perpetuity despite the fact that the returns of many of these companies would still remain well above the industry sector average even in the absence of additional USF support?

These companies chose the path of price cap incentive regulation -- a path that has rewards and risks. Thus, merely requiring them to show a true need of additional explicit subsidies for the purposes of universal service seems reasonable. After all, price cap carriers are generally less reliant than rate-of-return carriers on access revenues and are also able to take advantage of

[13] Supra note 6, at ¶203.

economies of scale, unlike smaller RoR carriers.

However, we must avoid punishing the customers of these companies, and therefore must provide a "safety net" -- not necessarily in the form of access recovery funds, but in a one-time path back to rate-of-return regulation. Thus we propose the Commission establish a forbearance mechanism for distressed price cap companies to violate the "permanent choice rule" and return to rate-of-return status.[14] However, to avoid the enriching that the permanent choice rule was originally established to prevent, the rate-of-return allowed for a carrier exercising this option should be substantially lower than 11.25 percent.

Ultimately, we recommend that any new access recovery funds be based on forward-looking cost estimates, even ARFs for rate-of-return carriers. The current ICLS funds available to rate-of-return carriers are based on embedded costs[15], despite the fact that the Commission has previously concluded that "universal service support for all carriers should be based on the forward-looking economic cost of constructing and operating the network used to provide the supported services, rather than each carrier's embedded costs".[16] When the Commission created the ICLS, it concluded that it was appropriate to base this support on embedded costs, but that this issue would be revisited in 5-years. Like the promise to revisit IAS, this never happened.

We also recommend that as a part of the Further Notice issued in this proceeding, the Commission seek input on the continued need for locking in "frozen" implicit access revenue subsidies even as access minutes are in rapid decline. We proffer that the current $650 million in IAS (established in 2000) and the current $1.5 billion in ICLS (established in 2001) are far in excess of actual need. The Further Notice should concur with this conclusion, and seek input on a phase down and eventual termination of these programs -- offset if needed with explicit broadband infrastructure support.

Improving the USF Reform Elements of
The Commission's Draft Proposal: Broadband

The Commission's Draft Proposal requires all USF-supported carriers to deploy broadband, at a minimum level of 768 kbps, to 100 percent of their service areas within a 5-year period. Carriers are required to cover their unserved areas at a rate of 20 percent per year over the 5-years. If the USF-supported carrier fails to meet this obligation, the area is put up for a reverse auction, with the

---

14 47 CFR 69.3(i)(4).

15 Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fifteenth Report and Order; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, Report and Order, Prescribing the Authorized Rate of Return From Interstate Services of Local Exchange Carriers, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613, FCC 01-304 (2001) (*MAG Order*); at ¶125.

16 MAG Order at ¶56 referencing Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9164-65 (1997).

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

www.freepress.net

reserve bid price set at the current study area per-line support level.

While we support modernizing the fund by incorporating broadband, we have serious concerns about the practical outcomes of this particular proposal.

First, we don't envision any non-rural carrier being able to meet their 100 percent obligation at the current level of support (which for most of these carriers consists of only minimal High-Cost Model (HCM) support and IAS support for geographically large study areas). We also don't envision other providers showing up to the reverse auction and meeting the reserve bid. This is simply because many of the non-rural study areas are geographically massive, such as the old Pac Bell study area which consists of 14 million access lines.

In these situations with no bidder, there is no improvement in broadband deployment from the status quo. This is what we call the "dead-end" scenario. Because carriers in such study areas face no penalties from failure to meet the 100 percent broadband deployment benchmark, they have no incentive to deploy based on the current level of support. Furthermore, even in study areas where a non-incumbent bidder wins the reverse auction, there's a high-likelihood that USF monies will be used to build or maintain broadband infrastructure in locations where other unsubsidized services already exist. This outcome would result in an unnecessary use of scarce resources.

The "dead-end" scenario is a very likely outcome. It is worth noting that no carrier has publicly stated that they will be able to meet the Draft Proposal's 100 percent benchmark at current support levels; and we should assume that this silence means that they cannot or will not.

If the Commission is determined to adopt a USF reform plan similar to that in the Draft Proposal, then we recommend the following changes.

First, the Commission should not use a specific speed benchmark of 768kbps. Instead, the standard should be service speeds and qualities (i.e. latencies) that are reasonably comparable to those available in that particular state.[17] This standard should also be flexible for the small portion of homes that are defined as "extremely high cost" (see next item). We recommend this issue be addressed in the Further Notice.

Second, the Commission should recognize that a very small percent of homes might be prohibitively expensive to serve. In this instance, the cost of serving the last one percent of unserved homes could dwarf the other 99 percent. Thus we recommend the Commission establish a case-by-case forbearance process where these extremely high-cost homes can be served using alternative technologies such as fixed wireless or satellite. The Commission should seek input in the Further Notice as to what the cost-differential should be in order to qualify for forbearance. A reasonable value may be on the order of 5 to 10 times the current average per-line cost for a given study area.

[17] The issue of latency is perhaps just as important as speeds. While some satellite broadband offerings may have speeds that exceed 768kbps, the latency of these services results in a user experience that is far different from those using low-latency technologies.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

Third, carriers should be required to offer buildout plans once a year for the 5-year period leading to 100 percent service deployment. If a carrier does not meet or does not plan to meet its obligations in any of the 5-years, then the auction process should commence immediately. Thus, if from day zero a carrier declares they cannot meet the buildout requirements, then the auction process should begin.

Fourth, in order to avoid the "dead-end" scenario describe above, if a study area is put up for reverse auction and receives no winning bidders, then the study area should be disaggregated. We recommend disaggregation into Census Block Groups (CBGs). Then, using the new Form 477 availability data (that we and others have urged the Commission to collect in a separate proceeding)[18], the Commission should identify the CBGs within a particular study area that are not served by any broadband provider.

Once the served and unserved areas of a study area are identified, the Commission or a state Commission should then designate a current broadband provider in the served portions of the study area as the Carrier of Last Resort (COLR). If there is one or more USF-supported broadband providers and one or more unsubsidized broadband providers in these served portions of a study area, then the unsubsidized provider should be designated by the Commission or state Commission as the COLR, either based on authority under Section 214(e)(3) of the Act or by negotiation. This newly designated COLR will not be eligible for USF support absent a showing of need (and need will be based on the cost of providing broadband and voice-grade service at retail rate reasonably comparable to the statewide average).

The USF monies that were previously distributed to the COLR in these served portions of the study area will then be redirected to supporting broadband in the unserved portions of the study area. The unserved portions of a study area will be bid out in a request for proposal (RFP) process, with a general cost-guideline used instead of a reserve bid (i.e., support will not be bound by the current POTS per-line support amount, recognizing that these areas will require increased USF support).

The scheme proposed in the above paragraphs is a carrot-and-stick approach that we believe will provide substantial incentives for current USF-supported carriers to meet the original 100 percent buildout obligations in order to avoid a "dead-end" first round auction and subsequent potential loss of support. This proposal -- by recognizing that many rural areas already have unsubsidized cable broadband service -- efficiently targets resources in the areas where the current USF-supported COLR cannot meet the buildout requirements. It also increases the amount of USF support available in the truly unserved areas by redirecting support away from areas where it is not needed.

We strongly recommend the Commission adopt this disaggregation approach. While we recognize that some carriers may be worried about a net loss in USF support under this approach, we believe

---

18 See for example Comments of Consumers Union, Consumer Federation of America, Free Press and Public Knowledge, In the Matter of *Deployment 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 (VoIP) Subscribership, WC Docket No. 07-38, July 17, 2008.

that most rural and non-rural carriers will actually see little net change as a result of a more precise targeting of USF support. If the Commission simply adopts the current Draft Proposal without making these modifications, the end result will be no meaningful increase in broadband deployment and continued misallocation of scarce USF resources.

Improving the USF Reform Elements of
The Commission's Draft Proposal: Mobility

The Commission's Draft Proposal caps support for mobile wireless CETCs at the current total level ($1.25 billion annually), but eliminates the Identical Support Rule (ISR). This means that in order for a wireless CETC to continue to receive support, they must participate in a cost proceeding. We are uncertain if this requires a CETC to file part 32 accounting and part 64 allocation documentation, or if the Commission will create a new cost-showing mechanism. However a CETC makes a cost showing, support will not be available unless it substantially exceeds a national benchmark. If no CETC in a study area undergoes a cost showing, the Commission's Draft Proposal designates that area for a reverse mobility auction, with the reserve price set at the lowest total CETC support for that study area. CETCs are required to meet the same 100 percent broadband benchmarks as incumbent carriers.

As supporters of universal affordable communications technologies, we support the idea that rural consumers should have access to mobility services at reasonably comparable qualities and rates. However, the framework established in the 1996 Act does not appear to square with the realities of today's communications marketplace, where mobility services are not in direct competition with wireline services; but are instead complementary services. Under the structure of the Act, if the Commission is forced to make choices on how to allocate scarce resources, we feel that the Act's principles lead the Commission down a path of supporting robust advanced telecommunications infrastructure, which may or may not have a mobility component.

This is why we ultimately think Congress must directly address the issue of a separate mobility support structure. However, in the interim, as the Commission makes changes to the Universal Service Fund, it must ensure a basic level of universal mobile voice service. Thus we recommend that the Commission, during the first year interim transition period, determine the populated areas where no mobile voice service would be available absent USF support. The Commission should then target its mobility funds towards those areas. Thus, if an area is served by one or more unsubsidized mobility providers, then no USF support should be provided in that area (irrespective of a CETC cost-showing). In areas with only unsubsidized mobility providers, support for the lowest cost-carrier should be awarded. And in the areas where no provider currently exists, mobility funds should be targeted for voice-grade infrastructure investments.

While we understand the Commission's desire to fund mobile broadband services, we don't think the case has been made that this is a necessary and efficient use of scarce USF resources. This is ultimately a threshold question that Congress must answer.

MASSACHUSETTS
40 main st, suite 301
florence, ma 01062
tel 413.585.1533
fax 413.585.8904

WASHINGTON
501 third street nw, suite 875
washington, dc 20001
tel 202.265.1490
fax 202.265.1489

freepress www.freepress.net

Conclusion

If the Commission makes the necessary changes outlined above, we believe it should move forward and adopt a Report and Order and Further Notice of Proposed Rulemaking at the November 4th open meeting. The question of which elements fall into which item remains open and to be determined by the commissioners. However, we favor a model in which the framework (starting points, end points, principles, and time-table) and initial steps appear in the Order, paired with an FNPRM that contains strong tentative conclusions for implementation and administration.

On the issue of ICC rate reform, the Commission should rule that access rates will be set on a path of reduction, and delegate the decisions about where final rates should land to the states. States should have the flexibility to decide whether the final cost-based reciprocal compensation rate should be uniform across all carriers, or if it is economically appropriate to have some level of variation. A path to an intermediate step of interstate rates over two years can be firmly established in the Order, and the details of the states' implementation process in the years after that can be examined in a Further Notice.

On the issue of SLC increases, we strongly urge the Commission to undergo a cost-review process before implementing any such increases. However, if it does rule that a SLC increase is appropriate while the FSJB decides the issue of a national benchmark, then the SLC increases must be commensurate with the declines in access charges. The Commission **must not** allow an across the board SLC increase of $1.50 in the initial years of the access transition, because this (along with the proposed increase in the business SLC) would result in an immediate offset of the full value of the access shift -- a shift that will not occur for many years. Allowing the full SLC increases in the early years of the transition gives LECs additional revenues that have not yet been lost, and this is simply unacceptable.

If the Commission is intent on immediate changes to the SLC, we urge it to determine the amount of access shift that will occur in the first two years of the transition (as rates go to interstate levels), and only allow SLC increases that offset this access decline. We estimate, based on very crude data, that the SLC increase needed during the first two years would be approximately 20 to 30 cents for primary residential lines. Finally, vertically integrated carriers who will be net beneficiaries of the decline in access charges should not be allowed to increase their SLCs.

On the issue of access recovery funding for the purposes of universal service, we strongly recommend that such funding be based on actual need, not a desire to make a carrier whole. All carriers should be required to quantify the actual amount of implicit support contained within their current access revenues, and then demonstrate this support is actually needed, and is not already offset by off-the-books unregulated revenue streams. If the Commission establishes an additional access recovery mechanism, then the support should be based on a carriers forward-looking cost, and take into account declining access minutes. The Commission should conclude that these new funds, and all access replacement funds will sunset in five years, absent further Commission action. If a price cap carrier cannot or will not make a needs-based cost showing, then a one-time path back to rate of return regulation (at a rate lower than 11.25 percent) should be permitted.

On the issue of declaring VoIP an information service, we **strongly** urge the Commission to leave this monumental decision to a Further Notice, as this change will completely upend the structure of Section 251 and create massive uncertainty as to the future of the entire industrial interconnection regime. There is simply no interconnection regime under Title I to ensure competitive access. Therefore this move would jeopardize the future of the advanced telecommunications market, something that is in direct conflict with Section 706 of the 1996 Act.

On the issue of universal service reform, we support the Commission's general goal of modernizing the USF to support broadband. But we have substantial concerns that the current framework in the Draft Proposal will not result in much change from the status quo. Indeed, the fact that no carrier has indicated their willingness to meet the 100 percent benchmark outlined in the Draft Proposal is indicative that no such outcome should be expected.

We feel that the reasonable comparability standard of the Act means that a 768kbps standard is arbitrary. A better approach would be to require services that are reasonably comparable those available in other areas within a given state. This, combined with a flexible approach to serving the last few very high-cost customers, will ensure that a substantial majority of consumers in a given study area have access to broadband services that are not of a quality which is years behind that available in urban areas.

We recommend a carrot-and-stick incentive-based approach that leads to study area disaggregation in the instances where there is no winning bidder. Under this approach, current USF funding will be diverted away from areas where broadband services are currently deployed by unsubsidized carriers, to the truly unserved areas.

Ultimately, we feel that the Commission should establish a solid framework in an Order, and issue a Further Notice with strong tentative conclusions that addresses the more difficult implementation issues. This approach is prudent, as many of the implementation details will need to be sorted out over the next year even if the Commission chooses to only issue a Report and Order. Thus many of the details that commenting parties are most concerned about (and are asking for an additional comment cycle on) can be dealt with in the Further Notice. We recommend a 3 to 6 month comment cycle and a 3 to 6 month deliberation cycle, culminating with a final Order on November 4th 2009.

Respectfully submitted,

FREE PRESS

By:

Ben Scott
Policy Director, Free Press

S. Derek Turner
Research Director, Free Press

501 Third Street NW,
Suite 875
Washington, DC 20001
202-265-1490
dturner@freepress.net

Dated: October 24, 2008