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**
	)	
Lifeline and Link Up	)	**WC Docket No. 03-109**
	)	
Universal Service Contribution Methodology	)	**WC Docket No. 06-122**
	)	
Implementation of the Local Competition	)	**CC Docket No. 96-98**
Provisions in the Telecommunications Act of 1996	)	
	)	
Developing a Unified Intercarrier Compensation	)	**CC Docket No. 01-92**
Regime	)	
	)	
Intercarrier Compensation for ISP-Bound Traffic	)	**CC Docket No. 99-68**
	)	
IP-Enabled Services	)	**WC Docket No. 04-36**
	)	
Numbering Resource Optimization	)	**CC Docket No. 99-200**

COMMENTS OF WINDSTREAM COMMUNICATIONS, INC.

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COMMENTS OF WINDSTREAM COMMUNICATIONS, INC.

Windstream Communications, Inc., on behalf of itself and its affiliates (collectively "Windstream"), submits the following comments in response to the request by the Federal Communications Commission ("Commission") for comment on its Further Notice of Proposed Rulemaking ("FNPRM") and three attached proposals on intercarrier compensation and universal service reform.[1]

[1] *See Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, FCC 08-262 (rel. Nov. 5, 2008) ("*Core Remand Order*").

I. INTRODUCTION AND SUMMARY

Windstream has consistently supported fair and balanced reforms of intercarrier compensation and universal service. The current regulatory system is ailing. But "cures" under consideration in the FNPRM would seriously injure or even permanently disable some of the telecommunications carriers that are subject to this system. If adopted without revision, the proposals would produce some combination of the following consequences: Broadband expansion in rural communities served by mid-sized companies would slow substantially or cease; existing broadband deployment would be scaled back; the quality of existing voice and broadband services would be degraded; retail prices for rural consumers would increase substantially; and the pace and number of job reductions in rural communities would accelerate. The Commission, therefore, should not adopt the proposals without making the modifications described in these comments.

Windstream endorses the Commission's overarching goal of "ensuring that broadband is available to all Americans."[2] With relatively little assistance from the federal high-cost fund,[3] Windstream has aggressively deployed broadband to approximately 85 percent of its customer base.[4] Now almost one million of its three million customers subscribe to broadband – a statistic that places Windstream's

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[2] *Id*. at App. A ¶ 4. If the same text is found in multiple Commission proposals, Windstream references this text by citing the applicable paragraph(s) in Appendix A.

[3] Windstream receives less than 1 percent of its total revenue from high-cost loop and model support, and less than 3 percent of its total revenues from all federal high-cost support combined.

[4] This access line statistic – like others referenced, unless indicated to the contrary – represents Windstream's ILEC access lines as of year-end 2007, excluding those recently acquired through Windstream's acquisition of CT Communications, Inc. Windstream's number of broadband-capable lines has increased significantly since September 2006, the first quarter after Windstream was formed as a result of its spin off from Alltel Corporation. Only 76 percent of Windstream's access lines were broadband-capable in September 2006.

broadband penetration ahead of its mid-sized incumbent local exchange carrier ("ILEC") peers and the Regional Bell Operating Companies ("RBOCs").[5] This performance is all the more impressive in light of the fact that Windstream, which serves primarily rural regions, operates in areas where deployment and operating costs are high and subscriber density is low.[6]

To offer service in its primarily rural service territory, Windstream must rely on private investment. Private investors enable Windstream and other mid-sized carriers to obtain debt financing, finance broadband deployment, and otherwise remain fiscally sound, so they can serve rural America. Such investors look for stability in the mid-sized carrier's financial position and the environment they operate within, including outside influences like the regulatory structure. The stability of a mid-sized carrier's business model is particularly important to the type of investors it attracts. These investors –

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[5]

Company	**Access Lines**	**Broadband Lines**	**Broadband Penetration**
AT&T	57,191,000	14,841,000	25.9%
Verizon	37,072,000	8,459,000	22.8%
Qwest	11,869,000	2,793,000	23.5%
Embarq	5,850,000	1,390,000	23.8%
Windstream	3,086,200	962,700	31.2%
Frontier	2,296,400	571,900	24.9%
CenturyTel	2,041,000	628,000	30.8%
Fairpoint	1,474,394	294,134	19.9%

Sources: Company financial reporting for 3rd Quarter 2008. Broadband penetration is the quotient of broadband lines divided by access lines.

[6] With an average subscriber density of approximately 20 access lines per square mile, Windstream offers telecommunications services to approximately 3.1 million access lines across 16 states. Windstream's annual capital expenditures exceed $300 million.

which include many public employee pension funds and insurance companies[7] – are drawn to mid-sized carriers due to their historic cash flows, ability to pay dividends regularly, and consistent levels of profitability. A mid-sized carrier's stock is similar to a bond in that equity investors do not expect stock appreciation over the long term, but rather obtain their expected return primarily through receipt of dividends.[8]

The proposals considered by the FNPRM, however, demonstrate a fundamental lack of appreciation for how this capital structure brings communications infrastructure investment to rural America. The proposals take issue with the fact that mid-sized carriers "consistently are paying dividends,"[9] as if the payment of dividends somehow signals that these carriers do not need the revenues to maintain current levels of service and make new investments. This criticism does not grasp the critical role that investors of these carriers play in maintaining and bringing voice and broadband services to high-cost, rural areas, and the role that dividends play in attracting such investors. Without payment of dividends, investors would have little reason to maintain their equity investments. The mid-sized price cap carriers, in turn, would have severely diminished access to debt and equity investments needed to fund their operations, and they would need more public funds to achieve the Commission's goal of broadband ubiquity.

Furthermore, the Commission's proposal for a new interpretation of "additional costs," pursuant to the pricing standards of Section 252(d)(2), would result in an irrational assignment of carriers' switching costs. The new interpretation would require

[7] Many investment firms also hold Windstream stock on behalf of individual investors or in income-focused mutual funds.

[8] Stock prices of mid-sized carriers, which are linked to generally flat or declining total revenues, typically would track such revenue expectations over the long term.

[9] *Core Remand Order* App. A ¶ 324.

that all common costs, including overhead costs and non-traffic sensitive costs ("joint and common costs"), to be excluded from the cost studies that determine terminating rates. Currently joint and common costs that are allocated to switching services are recovered from all users who generate switched traffic. But under the proposed regime, more switching costs would be classified as joint and common, and carriers would not be allowed to recover any of these costs from carriers using their switched network to terminate calls. Costs, therefore, would be shifted to consumers who purchase services that may not generate any switched traffic, for example, broadband Internet users. This mismatch between switching costs and consumer prices is an unjustified departure from current practice.

Reductions to intercarrier compensation rates, based on the new additional costs standard, are likewise unwarranted and would result in catastrophic revenue reductions. The Commission can find little support for its contention that uniform, near-zero intercarrier compensation rates would permit sufficient cost recovery. This conclusion is inconsistent with longstanding intercarrier compensation and universal service decisions that have reviewed switching costs in detail and determined that carriers in rural regions incur substantially different costs than carriers able to take advantage of economies of scale in urban regions. Instead of relying on this substantial record, the proposals turn to sources of the likes of Wikipedia, self-described as "the free encyclopedia that *anyone* can edit"; a *Telephony Online* interview of a then-BellSouth employee in 2006; and an unpublished presentation, which its author says adopts "perhaps over-simple cost estimates . . . [to] derive some perhaps plausible insights about . . . the future of consumer pricing."[10]

Imposing such sharp and unjustified reductions to intercarrier compensation revenues would make it substantially more difficult for mid-sized carriers to enhance and expand their broadband networks. Windstream estimates that the Commission's intercarrier compensation reforms would reduce company revenues by hundreds of millions of dollars over the foreseeable future, with little or no ability to recoup much of these substantial losses.[11] Relatively small changes in revenues will result in disproportionately large impacts on financial stability, including substantially reduced equity values and operating cash flows, and increased cost of access to equity and debt capital.[12] For an indication of how investors would react to the proposed rate reductions, the Commission need only look at the sharp decline in Windstream's and other mid-sized carriers' stock prices after proposed reforms were announced.[13] Such a change to a mid-

[10] *See id*. at App. A ¶ 261, n.688 (citing the Wikipedia entry "Broadband Internet Access," http://en.wikipedia.org/wiki/Broadband_Internet_access (last visited Oct. 11, 2008); Telephony Online, "OFC: BellSouth Chief Architect warns of HD VOD costs," March 7, 2006, http://telephonyonline.com/iptv/news/BellSouth_VOD_costs_030706 (last visited Oct. 11, 2008); David Clark, A Simple Cost Model for Broadband Access: What Will Video Cost?, Presentation at the Telecommunications Policy Research Conference (Sept. 28, 2008) (reporting the two prior estimates), *available at* http://tprcweb.com/files/Cost%20analysis%20TPRC.pdf).

[11] For 2008, Windstream's terminating intercarrier compensation revenues will comprise roughly six percent of its annual revenues, whereas all of its federal high-cost support will comprise less than three percent of its annual revenues.

[12] The high-fixed cost nature of a rural ILEC's business limits its ability to manage cash expenses. Letter from Michael J. Balhoff, Balhoff & Williams, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 05-337 (filed Oct. 28, 2008), 6. Consequently a "10% reduction in revenues can result in cash flow and equity declines of 40%, with the potential for equity to fall farther." *Id*. With reduced access to equity, carriers likely would be "compelled to make capital decisions that affect customers." *Id*.

[13] Between October 13, 2008, the day before the Chairman's reform proposal was announced, and October 29 Windstream's stock was down 27% – a $1.1B loss in market capitalization. By November 4, 2008, after the announcement that the Commission was not going to vote on the reform proposal, Windstream had recovered a large percentage of the decline and was only down 5% compared to October 13 or $211.0M in market capitalization. These reductions were significantly greater than the general market indexes over the same period, but similar to the declines of other mid-sized price cap carriers' stock prices.

sized carrier's intercarrier compensation revenues could trigger a mass exodus of the private investment necessary to sustain and advance operations. This risk is heightened now that the United States is experiencing one of the largest economic crises in its history.

The Commission would be unable to prevent the flight of private investors with a promise of possible, supplemental universal service support in the future, as permitted in the proposals. The proposals would allow this support only after the Commission considered all of a mid-sized carrier's revenues and found that the carrier was unable to return a "normal profit." This "opportunity" is ill-considered and likely ephemeral. It would effectively require carriers to offset their reduced intercarrier compensation with broadband revenues before they could be eligible for support. A carrier's incentive and ability to further deploy broadband in unserved areas would be significantly reduced. And by the time any Commission decision would be made (even if a carrier could meet the proposed draconian standard), a carrier already would have suffered significant losses – both in terms of short-run reductions in intercarrier revenues and liquidation of equity investment.

Damage from intercarrier compensation reforms would be exacerbated by the proposed universal service reform. Windstream and other similar carriers could not justify expenditures needed to meet the proposed broadband commitment, which would condition continued receipt of high-cost funds on ubiquitous broadband deployment. Windstream currently receives approximately $82 million in federal high-cost support, an amount that pales in comparison to the $250 to $400 million in capital costs and many millions more in annual operating costs that Windstream expects it would need to incur to offer broadband to its approximately 450,000 customers who currently do not have access to this service.[14] Thus, Windstream would have to forgo its high-cost support, and then would be subject to the proposals' ill-defined reverse auctions regime. Significant uncertainties surrounding the reverse auction process would plague Windstream's business plans and hinder its ability to attract private investment.

To truly advance broadband adoption, the Commission, instead, should revise its approach toward intercarrier compensation and universal service reform. First, intercarrier compensation reform should be more measured. Consistent with prior incremental reductions in rates, the Commission should bring interstate, intrastate and reciprocal compensation rates to interstate CALLS target rate levels over a three-year period, and in years four and five further reduce this rate to the lowest CALLS rate of $0.0055. Reform should allow impacted carriers to recover associated revenue losses to a significant degree through subscriber line increases and support from an Alternative Recovery Mechanism. Coupled with measures to address phantom traffic and clarify compensation applicable to interconnected Voice over Internet Protocol ("VoIP") providers, this approach toward reform would help rationalize the intercarrier compensation system, without seriously jeopardizing private investment in mid-sized price cap carriers. The Commission also should proceed with a thorough review of the "additional costs" standard. Any new standard, if the Commission concludes one is needed, should allow adequate recovery of joint and common costs from all switched traffic.

[14] Comments of Windstream Communications, Inc., WC Docket No. 05-337, CC Docket No. 96-45, at 13-14 (filed Apr. 17, 2008) ("Windstream USF Comments") (this capital expense projection is based upon offering broadband at speeds ranging from 768 Kbps to 1.5 Mbps).

Second, reform of the high-cost mechanism should focus on retargeting funds so that they are narrowly tailored to granular, high-cost areas most in need of support. As Windstream previously has explained,[15] the Commission's current high-cost program provides too much support to some ILECs and not enough to others, all without an objective way to assure service is affordable to consumers. But if these deficiencies are corrected, many high-cost areas that are currently uneconomic to serve would receive additional funding that would enable providers to shorten loops and perform other upgrades to dual-use plant. This funding would help justify business plans for expansion of broadband networks in high-cost areas. Collecting universal service support on a numbers basis would further rationalize the high-cost system.

Third, the Commission can boost broadband adoption in rural areas by adopting a Lifeline/Link Up Pilot Program that gives rural consumers a meaningful opportunity to receive broadband discounts. Under the proposed Pilot Program, Windstream and many other broadband providers in rural areas would not be able to participate, due to the requirement that participating providers offer broadband to all customers in their service territories. But if the eligibility criteria and distribution mechanism were modified, Lifeline and Link Up funds could provide a meaningful response to Section 254(b)(2)'s instruction that universal service funds help provide "[a]ccess to advanced telecommunications and information services . . . in all regions of the Nation."[16]

II. THE COMMISSION SHOULD ADOPT FAIR AND BALANCED INTERCARRIER COMPENSATION REFORMS THAT ADDRESS THE AREAS WHERE COMMISSIONERS HAVE IDENTIFIED A "GROWING MEASURE OF CONSENSUS."

[15] *See id*. at 4-11, 25-27 (describing these deficiencies).

[16] 47 U.S.C. § 254(b)(2).

The Commission's intercarrier compensation reforms should focus on areas where Federal Communications Commissioners have identified a "growing measure of consensus."[17] Such areas, specifically, include the following: (1) moving intrastate access rates to interstate access levels over a reasonable period of time; (2) implementing an Alternative Recovery Mechanism in certain circumstances; (3) not unduly burdening consumers with increases in their rates untethered to reductions in access charges; and (4) addressing phantom traffic and traffic stimulation.[18] The Commissioners also asked for input on how to define the additional costs standard utilized under Section 252(d)(2) of the Communications Act of 1934, as amended ("the Act")[19] and how to set the terminating rate for Section 251(b)(5) traffic. Constructive action on each of these issue areas is critical to ensuring the success of any plan to comprehensively reform intercarrier compensation.

Specifically Windstream recommends a series of concurrent, interrelated modifications that would ensure that intercarrier compensation reforms are more fair and balanced than any of the proposals being considered in the FNPRM. First, Windstream supports moving all of a carrier's rates to its interstate CALLS target rates by study area and then to the lowest CALLS rate of $0.0055, so long as the Commission provides for a reasonable opportunity for and appropriate level of recovery of intercarrier compensation revenue reductions, as well as reasonable time for this transition to occur. Second, any additional intercarrier compensation reforms under consideration should be subject to further, much needed review. Third, Windstream urges the Commission to adopt

[17] Separate Statement of Commissioners Michael J. Copps, Jonathan S. Adelstein, Deborah Taylor Tate, and Robert M. McDowell, *Core Remand Order*.

[18] *Id*.

measures that will curb phantom traffic. Finally, Windstream asks the Commission to clarify that interconnected VoIP providers are responsible for compensating circuit switched network providers for the use of their networks at the appropriate access rates. These recommendations are described below and in detail in an ex parte filed by Windstream on October 28, 2008,[20] attached to these comments as Appendix A.

Windstream's desire for a fair and balanced approach to reform is not narrowly limited to its own proposal. Windstream also supports other comparable frameworks designed to achieve the same result. For instance, concurrent with this filing, Independent Telephone and Telecommunications Alliance ("ITTA") and USTelecom propose thoughtful and reasonable modifications to the proposals under consideration in the FNPRM. The Commission should look closely at these recommended modifications and act now to adopt an order that reforms intercarrier compensation and universal service within the bounds of the similar frameworks suggested by the largely overlapping proposals filed by Windstream, ITTA, and USTelecom.

A. The Commission Should Transition Intrastate Access Rates to Interstate Levels Over a Reasonable Period of Time.

Windstream recommends that the Commission reasonably transition intrastate access rates to interstate levels. This measure would eliminate substantial arbitrage based upon disparities between interstate and intrastate access rates. With a reasonable transition period, it also would provide stability to broadband providers seeking to construct business plans for further development of their high-speed networks.

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[19] 47 U.S.C. § 151 *et seq*.

[20] Letter from Eric N. Einhorn, Windstream Communications, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 06-122, 99-68, 08-152, 07-135 (filed Oct. 28, 2008).

1. Windstream's Recommendations for Rate Reductions Are Consistent with the Trajectory Established by CALLS and MAG.

In the past, the Commission has moved forward with intercarrier compensation reform with deliberate and prudent steps to ensure progress while not derailing carriers' ability to serve consumers. The CALLS proceeding is an apt model for further intercarrier compensation reform.[21] Prudently, the Commission recognized in the *CALLS Order* that "one stroke of the sword" could not undo the "Gordian knot" of determining the appropriate level of access charges and converting implicit subsidies in those access charges into an explicit and sufficient Alternative Recovery Mechanism.[22] The *Order*, instead, adopted several steps over a five-year period that moved "toward the Commission's goals of using competition to bring about cost-based rates, and removing implicit subsidies without jeopardizing universal service."[23] The Commission found that this approach was "preferable and more reasonable . . . , even if incomplete, than to remain frozen with indecision because a perfect, ultimate solution remains outside our grasp."[24]

Following the trajectory established in the *CALLS Order* and the subsequent *MAG Order*, the Commission should adopt further intercarrier compensation reform that, again over a five-year period, will provide "stability during its term" and address several issues that have served as major obstacles to intercarrier compensation and universal service

[21] *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 (rel. May 31, 2000) ("*CALLS Order*") (reforming interstate access rates for price cap ILECs).

[22] *Id*. at ¶ 26.

[23] *Id*. at ¶ 36.

[24] *Id*. at ¶ 27.

reform.[25] Specifically, the Commission should require each carrier, on a study area basis, to reduce reciprocal compensation and intrastate access rates to their respective CALLS target levels by study area in measured increments over a three-year period. Then, by the fifth year, all terminating access rates for price cap carriers would be reduced to $.0055, the lowest CALLS target pursuant to Section 61.3(qq)(1). Specific details regarding each year of the proposed transition are provided in the ex parte Windstream filed on October 28, 2008, which is attached to these comments as Appendix A.

This proposed plan for intercarrier compensation reform, like prior Commission actions, would create a more rational rate structure that, in turn, "will support more efficient competition, more certainty for the industry, and permit more rational investment decisions."[26] Windstream's recommended intercarrier compensation reforms are measured, but significant. The Commission would tackle the most egregious problem first: arbitrage based upon disparities between interstate and intrastate access rates. Often the differential between these rates is significant. The Missoula Plan documented that the average access rates for small ILECs were $0.051 for intrastate traffic and $0.018 for interstate traffic, whereas the average rates for large ILECs were $0.025 for intrastate

[25] *Id*. at ¶ 35. *See also 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 (2001) ("*MAG Order*") (extending interstate access reform to rate of return carriers), *recon. in part*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, First Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twenty-Fourth Order on Reconsideration, 17 FCC Rcd 5635 (2002), *amended on recon.*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Third Order on Reconsideration, 18 FCC Rcd 10284 (2003).

[26] *CALLS Order* at ¶ 1.

traffic and $0.006 for interstate traffic.[27] Such disparities in rates tempt bad actors to mask intrastate traffic as interstate. But if Windstream's recommendations are adopted, arbitrage based on these rate disparities will be altogether eliminated. Moreover, where reciprocal compensation rate levels are higher than interstate rate levels, as is the case for Windstream and many other mid-sized price-cap carriers, rates would be fully unified at the interstate level.

2. The Commission Has Authority to Unify Interstate and Intrastate Access Rates as Proposed by Windstream.

Based on its own interpretations of the Act, the Commission retains authority to adopt the rate modifications Windstream proposes here.[28] Windstream's recommendations, whether traffic is subject to Section 251(g) or Section 251(b)(5), would not preclude the Commission from implementing further reductions in access rates, or from adopting another interpretation of additional costs at some point in the future. Findings in the *Core Remand Order* reaffirm the Commission's authority and discretion in this context.

Consistent with the legal framework adopted in the *Core Remand Order*, compensation for the transport and termination of traffic either is subject to

[27] Oregon Public Utility Commissioner Ray Baum, USF Reform and ICC Reform: Together Again? The Basics, Address Before the Summer Meeting at the National Association of Regulatory Utility Commissions, slide 23 (July 22, 2008), PowerPoint slides *available at* http://www.narucmeetings.org/Presentations/Baum%20NARUC%20July%2022%202008__071508%20FINAL.ppt.

[28] In these Comments, Windstream does not challenge but takes as given the Commission's previous legal interpretations, particularly as detailed in the recent *Core Remand Order*. Windstream notes, however, that other jurisdictional bases for comprehensive intercarrier compensation reform have been offered in this proceeding. *See, e.g.*, Letter from Melissa E. Newman, Qwest Communications International, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 04-36, 06-122, 05-195 (filed Oct. 7, 2008); Letter from Donna Epps, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, WC Docket Nos. 04-36, 06-122 (filed Sept. 19, 2008).

Section 251(g), or it is subject to Section 251(b)(5).[29] Section 251(g) preserves ILEC obligations for exchange access that predated the 1996 Act "under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[30] As the Commission has noted in its proposals, this statutory provision can be read to preserve both "the interstate access regime the Commission had prescribed for all carriers *and* the intrastate access regime the Bell Operating Companies had agreed to in the Modified Final Judgment."[31]

Under this interpretation, the Commission would have wide latitude to set rates for traffic governed by section 251(g), including intrastate traffic, and thereby adopt the access rate reforms proposed by Windstream.[32] This conclusion is bolstered by the D.C.

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[29] *See Core Remand Order* ¶ 16 (agreeing "with the finding . . . that traffic encompassed by section 251(g) is excluded from section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope"); *see also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, 16 FCC Rcd 9151, ¶¶ 31-34 (rel. Apr. 27, 2001).

[30] *See* 47 U.S.C. § 251(g) (emphasis added).

[31] *Core Remand Order* App. A ¶ 232, n.615. Section 251(g) authority to regulate interstate rates is especially clear. *See CompTel v. FCC*, 117 F.3d 1068, 1072-73 (8th Cir. 1997); *Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313, 324-25 (5th Cir. 2001). These charges unquestionably constitute pre-1996 Act obligations within the meaning of Section 251(g), and even the court in *WorldCom* assumed the Commission could rely on Section 251(g) to modify (as opposed to merely preserve) carriers' pre-Act obligations. *See WorldCom v. FCC*, 288 F.3d 429, 433 (D.C. Cir. 2002) ("We will assume without deciding that under Section 251(g) the Commission might *modify* LEC's pre-Act 'restrictions' or 'obligations,' pending full implementation of relevant sections of the Act.") (emphasis in original). *See also CompTel v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) (finding that Section 251(g) "plainly preserves certain rate regimes already in place"). Further, it is well established that Section 201 grants the Commission authority to ensure that rates for *interstate* services are "just and reasonable." *See, e.g., U.S. v. Western Elec. Co. Inc.*, 531 F.Supp. 894 (D.N.J. 1981); *see also* Letter from Gary L. Phillips, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-98, 99-68, at 2 (filed May 9, 2008) (noting that prior to the enactment of the 1996 Act, the Commission established the compensation rules collectively known as the "ESP exemption" by relying on its Section 201 authority). Congress's intention to preserve this authority is codified by Section 251(i). 47 U.S.C. § 251(i).

[32] *See Petition of Core Communications, Inc. for Forbearance From Sections 251(g) and 254(g) of the Communications Act and Implementing Rules*, Memorandum Opinion and Order, 22 FCC Rcd 14118, ¶ 14 (rel. Jul. 26, 2007) (finding that "enforcement of the rate regulation preserved by section 251(g) and its related implementing rules remains necessary to ensure that intercarrier charges and practices are just and reasonable and not unreasonably discriminatory").

Circuit's prior conclusion that the Commission may take action to end the access charge regimes ushered in by that provision.[33] The Commission has reasoned in its proposals that "inherent within the [Commission's] power to supersede the grandfathered access regime is the lesser power to prescribe regulations that determine *how* to transition to a cost-based pricing mechanism."[34]

Even if the Commission concludes that certain categories of traffic are not currently subject to Section 251(g), however, the Commission could set rates for those categories pursuant to Section 251(b)(5). The Commission's reading of the Act in the *Core Remand Order* means that Section 251(b)(5) can apply to both *interstate and intrastate* access rates.[35] The *Order* interpreted Section 251(b)(5) to encompass all forms of telecommunications traffic, regardless of whether that traffic is considered to be "local" or "long distance" in nature.[36] The Commission's examination of Section 251(b)(5), which imposes on local exchange carriers the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications,"[37] found that this provision does not include limitations based on geography (i.e., "local," "intrastate," or "interstate") or the particular service offered.[38] The Commission added

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[33] *See WorldCom, Inc. v. FCC*, 288 F.3d 429, 431 (D.C. Cir. 2002) (finding that section 251(g) is a transitional device "until such time as the Commission should adopt new rules according to the Act").

[34] *Core Remand Order* App. A ¶ 232 (emphasis in original).

[35] In the *Core Remand Order,* the Commission conceded that there may be more than one plausible interpretation of Section 251(b)(5), but under its view including "all telecommunications" within the potential scope of Section 251(b)(5) constituted "the better reading" of the Act. *See Core Remand Order* ¶ 15. Although the D.C. Circuit's *WorldCom* decision rejected the view that Section 251(g) constitutes a "limitation" on Section 251(b)(5) with respect to ISP-bound traffic, the court did not question the Commission's express finding that Section 251(b)(5) applies to *all* telecommunications traffic.

[36] *Core Remand Order* ¶ 13, n.49.

[37] 47 U.S.C. § 251(b)(5).

[38] *Core Remand Order* ¶ 8.

that Congress had the option of proscribing categories of traffic from the reach of Section 251(b)(5), but elected not to do so.[39]

Because of this applicability to intrastate (as well as interstate) traffic, the Commission retains authority to adopt Windstream's proposed reforms when traffic falls under Section 251(b)(5), rather than Section 251(g). The Act authorizes the Commission to prescribe rules and regulations "as may be necessary in the public interest to carry out the provisions of this Act."[40] As the Supreme Court made clear in *AT&T v. Iowa Utilities Board*, this rulemaking authority is not limited to jurisdictionally interstate matters covered by Section 201, but extends to *all* provisions in the Act, including the provisions that once fell within the exclusive jurisdiction of the states prior to 1996.[41] Thus, the Commission may adopt rules implementing Section 251(b)(5) for interstate *and* intrastate traffic. Moreover, the Commission may adopt rules that affect how state commissions establish the prices that carriers pay each other pursuant to Section 252(d)(2), which details the pricing standards for traffic covered by Section 251(b)(5).[42]

B. To Ensure Carriers Have a Meaningful Opportunity to Recover Intercarrier Revenue Reductions, the Commission Must Provide an Alternative Compensation Recovery Mechanism and Permit Carriers to Increase Subscriber Line Charges.

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[39] *Id.*

[40] 47 U.S.C. § 201(b).

[41] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378-86 (1999).

[42] 47 U.S.C. § 252(d)(2). Under the *Core Remand Order*'s legal framework for ISP-bound traffic, interstate traffic subject to Section 251(b)(5) also is subject to the Commission's Section 201 authority. The Commission explained that Section 251(i) retains the Commission's preexisting, independent authority over interstate matters despite the existence of a "parallel" federal/state jurisdictional arrangement under sections 251 and 252 of the Act. *Core Remand Order* ¶ 18. Thus, despite acknowledging that ISP-bound traffic is Section 251(b)(5) traffic, the Commission concluded that it could separately regulate and set rates for that traffic under its Section 201 authority. *Id.* ¶ 21. The Commission stated that its independent Section 201 authority includes the power "to regulate intercarrier compensation with respect to interstate access services, rates charged by CMRS providers, and other traffic . . . such as ISP-bound traffic." *Id.* ¶ 17.

As described above, the Commission has long held the goal of removing implicit support contained in intercarrier charges and moving such charges toward economically efficient levels.[43] In taking steps toward this goal, the Commission, where it has removed implicit support, has replaced it with explicit support.[44] The Commission has recognized that creating an Alternative Recovery Mechanism is critical to carriers' ability to offer services in higher cost areas that are reasonably comparable to those offered in lower cost areas.[45] For example, the *CALLS Order* found that creating a new Interstate Access Support mechanism was needed to satisfy the "dual goals of providing explicit and sufficient universal service support while promoting local competition."[46]

There is no rational basis for breaking from the Commission's past practice of establishing Alternative Recovery Mechanisms when it reduces carrier revenues as a result of intercarrier compensation reform. The intercarrier compensation reforms proposed today, like those previously enacted, "could result in a substantial decrease in revenue for incumbent LECs, which could prove highly disruptive to business operations."[47] Indeed, the proposals under consideration by the Commission could result in unprecedented reductions in mid-sized carriers' intercarrier compensation revenues.

Any significant reduction in intercarrier compensation revenues, therefore, must be offset in significant part by a meaningful Alternative Recovery Mechanism. A wide

[43] *See, e.g., Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges*, First Report and Order, 12 FCC Rcd 15982, ¶ 44 (rel. May 16, 1997) ("*Access Charge Order*") (declaring that the Commission has the "goal of removing implicit universal service subsidies from interstate access charges and moving such charges toward economically efficient levels").

[44] *See CALLS Order* ¶ 3 (replacing implicit support with explicit support); *MAG Order* ¶ 8 (same).

[45] *See CALLS Order* ¶ 201; *MAG Order* ¶ 128.

[46] *CALLS Order* ¶ 192. *See also id.* at 195 (establishing an explicit interstate universal service support mechanism).

[47] *Access Charge Order* at ¶ 46.

array of parties support the need for such a mechanism.[48] Consistent with these parties, Windstream urges the Commission to provide mid-sized price cap carriers access to a mechanism for reasonable recovery of lost intercarrier compensation revenues. This recovery mechanism, described in detail in Appendix A, would *not* make Windstream and other similarly situated carriers whole as compared to their position under the current intercarrier compensation regime.[49]

Any ability to recover intercarrier compensation revenues would be offset first by proposed subscriber line charge ("SLC") increases (i.e., $1.50 for residential and single line business and $2.30 for multi-line business). SLCs should be imputed when calculating support available under the recovery mechanism. Designing the mechanism in this manner would provide appropriate continuation of universal service support, while

[48] *See, e.g.,* Letter from Larry Cohen, Communications Workers of America, President, to Kevin Martin, Chairman, FCC, WC Docket Nos. 06-122 and 05-337, CC Docket Nos. 96-45 and 01-92 (Oct. 27, 2008), at 3 (urging the Commission to "establish a supplementary explicit universal service fund available to mid-size carriers for broadband build-out"); Letter from Brian Mefford, Connected Nation, Chairman and CEO, to Kevin Martin, Chairman, FCC, WC Docket Nos. 06-122 and 05-337, CC Docket Nos. 96-45 and 01-92 (Oct. 27, 2008), at 2 (urging the Commission to establish universal service recovery mechanisms that "should be available to all carriers of last resort, regardless of company size, structure or regulatory classification"); Letter from Walter McCormick, USTelecom, President, to Kevin Martin, Chairman, FCC, CC Docket No. 01-92 (Oct. 10, 2008), at 5, 7, 8 (declaring that "establishment of a credible and compensatory ARM is an essential element of comprehensive intercarrier compensation reform"); Letter from Curt Stamp, ITTA, President, to Secretary Dortch, Secretary, FCC, CC Docket No 01-92 (Sept. 19, 2008), at 5 (recommending that mid-sized carriers be able to use an Alternative Recovery Mechanism); Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, et al. to Kevin Martin, Chairman, FCC, CC Docket No. 01-92 (filed July 24, 2006) (attaching the Missoula Plan) (proposing a plan that included a recovery mechanism, which could be used by mid-sized carriers) ("Missoula Plan Ex Parte Letter").

[49] There are several reasons why this recovery mechanism would not make Windstream whole. First, Windstream's interstate access rate reductions to its target CALLS rates resulting from its conversion to price cap regulation would not be recovered via the intercarrier compensation replacement mechanism. Windstream is required to reduce its interstate access rates to its CALLS targets, but under this proposal the transition to the lower rate would be accomplished in three years, rather than the longer transition provided under the CALLS rules. Second, only 50 percent of the revenue reduction resulting from interstate, intrastate, and reciprocal compensation rate reductions from $.0065 to $.0055 would be recovered through the replacement mechanism. Third, the increased subscriber line charges would not be fully recovered, as rate increases are restrained by competition.

not unduly burdening consumers with rate increases untethered to access charge reductions.

In contrast, failure to adopt such an Alternative Recovery Mechanism would be contrary to Section 254 of the Act. Without a meaningful opportunity for recovery, mid-sized price cap carriers seeking to maintain their current operations would have to ask their customers in lower cost areas to pay increased rates in order to implicitly subsidize delivery of comparable, affordable telecommunications services to customers residing in high cost areas. *Effectively this approach means the Commission merely would replace one form of implicit universal service support with another form of implicit universal service support*. Such a measure would be in direct contravention of the Congressional directive that universal service support "should be explicit and sufficient to achieve the purposes" of Section 254, which includes the purpose that all Americans should have access to telecommunications services at affordable and reasonably comparable rates.[50]

C. Further Comment and Review Is Needed Before the Commission Modifies the Longstanding Additional Costs Standard.

In their separate statement, the four Commissioners specifically sought input on how to define the additional costs standard utilized under Section 252(d)(2) of the Act and how to set the terminating rate for Section 251(b)(5) traffic. As described below in Section III.A, there are a number of significant issues with the new "additional cost" standard and the uniform, near zero terminating rates proposed in Attachment A and C. The short comment period and even shorter reply period do not allow parties to consider and comment on all such issues. The Commission also lacks sufficient time to consider

[50] 47 U.S.C. § 254(e).

any record that could be developed even if parties were afforded more time to comment on the additional costs standard.

Given these practical difficulties, Windstream again urges the Commission to seek additional comment on what steps to take following the reduction of intrastate, interstate, and reciprocal compensation rates to the lowest CALLS interstate rate level over five years. Specifically, Windstream suggests that the Commission explore, among other items: whether to establish one unitary rate for all intercarrier compensation; unified rates by carrier, state, or track; the methodology for setting rates and establishing "additional cost" under Section 252(d)(2); and the proper role of state commissions, the Federal-State Separations and Universal Service Joint Boards, and the Federal-State Joint Conference on Advanced Telecommunications Services. This recommendation is consistent with the questions and tentative consensus described in the Separate Statement and would allow for a meaningful opportunity for comment by the public and consideration by the Commission. Moreover, seeking additional comment will not unduly delay the Commission from further action if warranted and supported, given it will take a matter of years to move beyond even the first step included in the proposals put out for comment by the Commission.

D. To Enable Proper Billing, the Commission Should Adopt Reforms That Specifically Address Phantom Traffic.

Windstream largely supports the phantom traffic reform measures proposed by the Commission. Proposed phantom traffic reforms are generally consistent with those included in USTelecom's phantom traffic proposal, which Windstream and a majority of the wireline telecommunications industry support.[51] Like the USTelecom recommendations, the Commission's proposed reforms, among other items, would implement call signaling rules to prohibit stripping or altering information in the SS7 call signaling stream[52] and clarify that the prohibition on altering or stripping signaling information applies to the charge number as well as the calling party number.[53] In addition, the proposed rules would establish payment obligations for service providers that fail to provide the required call detail information.[54] These reforms would help ensure the proper labeling of traffic so carriers can appropriately bill for carrying it.

Windstream, however, recommends two modifications to the phantom traffic measures under consideration by the Commission. First, Windstream, consistent with the USTelecom proposal, asks the Commission to extend the *T-Mobile* decision to negotiations between ILECs and competitive local exchange carriers ("CLECs").[55] This extension would provide ILECs with the right to engage competitive local exchange carriers in negotiations and, if necessary, arbitration for agreements that would establish intercarrier compensation rates, terms, and conditions.[56] Second, Windstream, also like the USTelecom proposal, requests that the Commission require carriers to perform local number portability queries.[57] These modifications would help ensure that originating and intermediate carriers deliver traffic to the correct terminating carriers, making it possible

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[51] Letter from Glenn Reynolds, USTelecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Feb. 12, 2008), Attachment ("USTelecom Phantom Traffic Proposal").

[52] *Core Remand Order* App. A ¶ 331.

[53] *Id*. at App. A ¶ 333.

[54] *Id*. at ¶ 329.

[55] USTelecom Phantom Traffic Proposal.

[56] Extension of *T-Mobile* is particularly warranted for ILECs that receive traffic from CLECs indirectly through an unaffiliated tandem switch.

[57] USTelecom Phantom Traffic Proposal.

for ILECs to negotiate agreements with all carriers terminating traffic on their networks, and reduce the amount of improperly billed traffic.

E. The Commission Should Clarify That Compensation is Due for IP/PSTN Traffic.

Windstream strongly urges the Commission to clarify that compensation for IP/PSTN traffic should flow immediately. Requiring compensation for this traffic is critical to achieving the Commission's goal of minimizing arbitrage. As the Commission itself has emphasized, "any service provider that sends traffic to the PSTN should be subject to similar compensation obligations, irrespective of whether the traffic originates on the PSTN, on an IP network or on a cable network."[58]

Failure to require compensation for IP/PSTN traffic would be contrary to the Commission's desire for a more economically rational intercarrier compensation scheme. Moreover, deferring clarification that compensation is due for IP/PSTN traffic would only introduce further complications, as this traffic is likely to continue growing dramatically. Risks of arbitrage would significantly expand in upcoming years – likely to the particular detriment of consumers and carriers in high cost, rural areas.[59]

In addressing whether compensation is due for IP/PSTN traffic, the Commission need not reach the question of whether IP/PSTN service should be classified as an "information service" or a "telecommunications service." Under the Commission's own

[58] *IP-Enabled Services*, Notice of Proposed Rulemaking, 19 FCC Rcd 4863, ¶ 33 (rel. Mar. 10, 2004) (*"IP-Enabled Services NPRM"*).

[59] *See, e.g.*, Tom Burton, "Twenty Percent Annual Growth for VoIP," FierceVoIP (Feb. 25, 2008) (citing the Telecommunications Industry Association's 2008 *Market Review and Forecast*, which predicts that the domestic residential VoIP market will grow at a compounded annual rate of twenty percent over the next four years). *See also* Letter from Eric Einhorn, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45 and 01-92; WC Docket Nos. 99-68, 05-337, 06-122, 07-135, and 08-152 (Oct. 27, 2008) ("Windstream Softswitch Ex Parte") (explaining why rural areas are unlikely to see the same level of VoIP deployment as urban areas).

reading of the Act, Section 251(b)(5) applies to the "transport and termination of telecommunications," which would seem to cover both telecommunications offered to the public for a fee (*i.e.,* "telecommunications services") and "telecommunications" itself.[60] Moreover, past Commission decisions demonstrate that the agency could rely on its ancillary authority to impose Title II obligations on IP/PSTN services, without making a decision as to the statutory classification of these services.[61]

III. INTERCARRIER COMPENSATION REFORMS INCLUDED IN THE COMMISSION'S PROPOSALS WOULD JEOPARADIZE COMMUNICATIONS SERVICES OFFERED BY MID-SIZED PRICE CAP CARRIERS.

The intercarrier compensation reforms considered by the FNPRM would undermine the ability of mid-sized price cap carriers to offer quality, affordable communications services in rural areas. The proposal to replace the existing incremental cost definition with another is both unwarranted and ill-considered. It has troubling legal and public policy implications. Mid-sized price cap carriers, subject to this new standard, would struggle to maintain current operations, let alone deploy further broadband networks. Without an adequate mechanism to recover lost revenues, mid-sized carriers and their rural customers would suffer the full weight of these ill-considered reforms.

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[60] *See* 47 U.S.C. §§ 153(43) & (46). *See also Core Remand Order* App. A ¶ 218 n.564 (noting that "information services, by definition, are provided 'via telecommunications,' enabling [the Commission] to bring IP/PSTN traffic within the section 251(b)(5) framework."). Thus, by this same reasoning Section 251(b)(5) applies to IP/PSTN services regardless of whether these services are classified as telecommunications services or information services.

[61] The Commission has used its ancillary authority to impose Title II obligations on "interconnected VoIP" in multiple instances. *See IP-Enabled Services NPRM; E911 Requirements for IP-Enabled Service Providers*, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245, ¶ 24 (rel. Jun. 3, 2005) (requiring interconnected VoIP providers to supply 911 capabilities for services that utilize the PSTN); *Universal Service Contribution Methodology*, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518, ¶¶ 38-49 (rel. June 27, 2006) (establishing universal service contribution requirements for interconnected VoIP providers); *Implementation of the Telecommunications Act of 1996; Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 6927, ¶¶ 54-59 (rel. Apr. 2, 2007) (extending the application of CPNI rules to interconnected VoIP providers).

A. The Proposed Additional Costs Standard Produces an Irrational Assignment of Switching Costs.

The Commission's proposal for a new interpretation of "additional costs," pursuant to the pricing standards of Section 252(d)(2), would significantly change how costs for terminating traffic are calculated. Use of the proposed additional costs standard would result in an irrational assignment of switching costs. Currently joint and common switching costs are recovered from all users who generate switched traffic. But under the proposed regime, the vast majority of switching costs would be classified as joint and common, and these costs would not be allocated to carriers using the switched network to terminate traffic. The newly enlarged pool of joint and common costs would only be recovered from a subset of users who generate switched traffic (i.e., originating customers and the carrier's own local customers). Also other consumers – who may generate little or no switched traffic – would have to assume responsibility for some of the joint and common costs previously allocated to switching services. This mismatch between switching costs and consumer prices is unjustified and would distort competition among communications providers.

Any new additional costs standard should recognize that different carriers incur different degrees of switching costs. Switching costs per minute are much greater in rural areas, where switching facilities support fewer calls than switching facilities in urban areas. The Commission has a longstanding practice of recognizing cost differences in the context of not only intercarrier compensation, but also in the context of universal service support.[62] Failure to continue recognizing this distinction would be contrary to economic reality and would constitute an unjustifiable departure from agency precedent.

There will continue to be significant cost differences between rural and urban carriers, even if all such carriers deploy soft-switches throughout their networks. The Commission's proposals attempt to discount agency precedent with the assertion that modern circuit and soft switches will impose little or no costs under the proposed standard.[63] The proposals assert that modern softswitches are "non-blocking, which would suggest that the incremental cost of termination is zero" and that "softswitches are easily scalable, and thus the incremental cost of termination does not vary with the number of lines the switch serves."[64] But as discussed in more detail below, the incremental cost of termination is near zero under the proposed additional costs standard not due to the degree of blocking or scalability of a type of switch, but instead due to the fact that the proposed standard classifies a much greater proportion of switching-related costs as joint and common and then excludes these costs from the calculation of additional cost.[65]

1. The Proposed Additional Costs Standard Would Skew How Costs are Assigned by Only Requiring a Subset of Switched

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[62] *See, e.g.*, 47 CFR 54.301(a) and *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, ¶ 212 (rel. May 8, 1997) (establishing local switching support in recognition that carriers serving rural areas must incur higher switching costs to provide voice service to an individual customer); *CALLS Order* ¶ 162 (recognizing differences between urban and rural price cap ILECs when establishing different interstate average traffic sensitive charges for different classes of carriers). *See also* C. A. Bush et al., Computer Modeling of the Local Telephone Network, App. B, 39 (Oct. 1999) *available at* http://www.fcc.gov/wcb/tapd/hcpm/welcome.html (describing how the forward-looking universal service cost methodology responds to differences in switching costs incurred by carriers of different sizes).

[63] *See e.g., Core Remand Order* App. C ¶¶ 250, 252 & 269.

[64] *Id.* at App. C ¶¶ 250, 269.

[65] For this reason, these comments focus on proposed changes to how joint and common costs are categorized and assigned. But for an additional review of why it is altogether inappropriate to consider use of softswitches, see Windstream Softswitch Ex Parte (indicating that for now and the foreseeable future it would be inefficient to use softswitches in rural areas).

Traffic to Pay for Costs that Are Joint and Common to All Switched Traffic.

The fact that the ILEC network is largely in place does not mean that it has been fully paid for. Recovery of switching costs has always been part of the rate setting principles in telecommunications, and the recovery of switching investment and associated direct expenses has traditionally been included in the cost of all switched minutes (intrastate, interstate, and local) over the useful life of the switch. The Commission consistently has regulated setting of depreciation rates and lives through the depreciation standards in Section 43.43 of the Commission's rules.[66]

The Commission's revised additional costs standard, however, would radically change how carriers recover their switching costs. Although both standards are based on incremental cost, the revised additional costs standard is different from the existing standard in two key respects. First, the revised standard classifies more costs as "joint and common." The standard in the proposals would include switching investment and associated direct expenses in the pool of joint and common costs, whereas today the Commission would not.[67] Second, the revised additional costs standard would preclude carriers from recovering switching investment and other joint and common costs from terminating traffic.[68] Together these changes would significantly reduce the degree to which switching costs can be recovered from terminating traffic. Terminating rates, to the extent they were based on the proposed additional costs standard, would drop to levels at or near zero.

[66] 47 C.F.R. § 43.43.

[67] *Core Remand Order* App. A ¶ 271.

[68] *Id.* at App. A ¶ 273.

These revisions to the additional costs standard are contrary to the very goals set forth in the Commission proposals. The proposals are premised on the notion that "a minute is a minute" for the purposes of generating costs.[69] Yet for setting prices, applying the revised additional costs standard will mean that some users generating switched minutes will pay for joint and common switching costs, while other users generating switched minutes will not. Now the only switched traffic required to bear joint and common costs will be originating access calls or local calls that stay on a single carrier's networks (i.e., switched traffic not subject to Section 251(b)(5)). Alternative carriers will benefit from being able to interconnect with other networks,[70] but will not be responsible for a reasonable amount of the expanded pool of joint and common costs incurred to provide this benefit.

2. Under the Proposals, Carriers Subject to the New Additional Costs Standard Would Be Forced to Recover Some of Their Switching Costs from Customers Purchasing Broadband and Other Services That Do Not Even Use Switches.

Imposing the revised additional costs standard gives rise to an important question: If users generating terminating access traffic are no longer responsible for their former share of switched investment, direct switching expense, and joint and common switching costs, who is? These costs must be recovered from some source. Basic economic theory dictates that companies like telecommunications carriers must set prices above marginal

[69] Different rates for the same function violate the Commission's goal requiring similar rates for like traffic. *See id*. at App. A ¶ 178 (criticizing instances where "arbitrage in the marketplace" occurs "because of the different rates for similar functions").

[70] As the draft order notes in a different context, each carrier benefits from another's network, because each network connects end users that may make or receive calls from other networks. *Id*. at ¶ 109.

costs: "If marginal cost is less than the average total cost per unit, and prices are set at the former level, total revenues will be less than total costs."[71]

To some degree carriers may seek to recover joint and common costs previously recouped through terminating access rates from switched traffic not subject to Section 251(b)(5) pricing regulation. But carriers' ability to recover costs from this traffic would be significantly limited by statute and pricing regulations. First, Section 254(k) of the Act establishes that the Commission cannot allow "services included in the definition of universal service [to] bear . . . more than a reasonable share of the joint and common costs of facilities used to provide those services."[72] Second, federal and state pricing regulations would directly restrict rates placed on originating traffic and local traffic within a single carrier's network. The Commission's proposals would prohibit any increases in originating access rates during the proposed transitional mechanism.[73] Similarly, state alternative regulation plans often either freeze local rates for a specified period of time, or limit local rates to specified price increases pursuant to a price cap formula.

To the extent Section 254(k) and pricing rules prevent full recovery of joint and common costs from non-Section 251(b)(5) traffic, carriers will have no choice but to seek recovery of remaining joint and common switching costs from services that do *not even use* switching facilities. This means broadband customers, who do not use switching services, will likely experience higher prices to help offset switching costs not recoverable from parties that use the switch. Forcing carriers, in effect, to shifting costs

[71] 1 ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 130 (6th ed. 1995).

[72] 47 U.S.C. § 254(k).

in this manner – arising in the absence of a clear statutory directive or overriding policy interest – is irrational, unjustified, and should be avoided by the Commission.

3. Applying the Proposed Additional Costs Standard Would Result in Less, Not More, Broadband Deployment in High-Cost Areas.

The Commission, in large part, bases its decision to revise the additional costs standard on the incorrect, unsubstantiated belief that eliminating intercarrier compensation revenues will somehow clear the way for an all-IP broadband world.[74] The Commission only cites a Phoenix Center filing as justification for this belief. In that filing, the Phoenix Center constructs a model that "finds" that "in high-cost areas, the incentive of an incumbent LEC to upgrade its network to broadband service is diminished – and perhaps even outright deterred – by the current system of high, carrier-specific call termination rates."[75] It reasons that "cannibalization of existing access revenue may occur when a LEC upgrades to broadband, which accordingly facilitates the migration of its customers to VoIP and other technologies that bypass higher priced access services."[76]

The Phoenix Center filing provides dubious support for the Commission's proposals. It is unclear how its "model" can "find" anything when no numbers are inserted into its equation. Indeed, the Phoenix Center stops short from arguing the intercarrier compensation regime has *ever* caused broadband investment to be "outright

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[73] *Core Remand Order* App. A ¶ 229.

[74] *See id*. at App. A ¶ 189 (asserting that the existing intercarrier compensation regulatory regime poses "an obstacle to the transition to an all-IP broadband world").

[75] T. RANDOLPH BEARD & GEORGE S. FORD, DO HIGH CALL TERMINATION RATES DETER BROADBAND DEPLOYMENT? (Phoenix Center Policy Bulletin No. 22, Oct. 2008) 8, *available at* http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf.

[76] *Id*. at 3.

deterred."[77] It "impress[es] upon the reader" that its "focus in this discussion is rather narrow and directed" and its review is not sufficient for it to support proposed intercarrier compensation reforms.[78] The Phoenix Center cites no specific instance where the desire to avoid losing some intercarrier revenues would outweigh a carrier's desire to obtain new broadband customers, and have any impact on broadband deployment.

The model's "finding," in fact, is contrary to substantial evidence of investment in rural broadband networks. Windstream's investment history makes it clear that the incentive to open up new broadband revenue streams far outweighs any theoretical incentive, if one even exists, to prevent further loss of intercarrier compensation revenues. Given declining revenues from traditional voice services, wireline carriers like Windstream have aggressively deployed broadband in an effort to retain customers and develop new revenue sources. Already Windstream has invested hundreds of millions of dollars in deploying broadband in rural America. And in the company's third quarter earnings call held earlier this month, Windstream Chief Executive Officer Jeff Gardner reaffirmed that Windstream is "very much aligned with the FCC's objective to deploy broadband to rural America, as evidenced by our plans to get to 88 percent broadband addressability [by year's end] and our industry leading broadband penetration."[79]

In the limited instances where it has not deployed broadband, Windstream's investment decisions are dictated solely by an assessment of whether projected revenues and operational savings will outweigh the associated investment and ongoing operating

[77] *Id*. at 8.

[78] *Id*. at 4.

[79] Jeff Gardner, Remarks on the Third Quarter 2008 Windstream Communications Earnings Call (Nov. 7, 2008) (citing statistics based on access lines including those acquired through Windstream's acquisition of CT Communications, Inc).

costs.[80] As noted above, Windstream has estimated that it would cost $250 to $400 million to deploy broadband to reach the approximately 15 percent of its customers who currently do not have access to broadband.[81] Windstream then would need to spend many millions more on ongoing broadband operating costs.[82] It is absurd to think that a reduction in intercarrier compensation rates would change a mid-sized price cap carrier's decision about whether to incur these overwhelming costs – other than to make it *more difficult* for a carrier to dedicate already scarce funds to further deployment of advanced services.

4. Replacing the Existing Additional Costs Standard, Which Is Legally Sound, With the Proposed New Standard Would Generate Uncertainty and a New Round of Legal Challenges.

Longstanding Commission precedent supports recovery of a reasonable allocation of joint and common costs from intercarrier compensation rates.[83] This approach toward recovery, embodied in the Total Element Long *Incremental* Cost Standard ("TELRIC"), has survived legal scrutiny and the test of time.[84] The Commission has deemed the TELRIC methodology to be consistent with its "forward-looking, economic cost

[80] This assessment is required for any public, for-profit business.

[81] Windstream USF Comments (this capital expense projection is based upon offering broadband at speeds ranging from 768 Kbps to 1.5 Mbps).

[82] *Id*. at 14-15 (such operating costs encompass, but are not limited to, transport fees that Windstream must pay to connect island exchanges to the Internet backbone).

[83] *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 15499 (rel. Aug. 8, 1996) ("*Local Competition Order*") ¶ 1058:

> Rates for termination pursuant to a TELRIC-based methodology may recover a reasonable allocation of common costs. A rate equal to incremental costs may not compensate carriers fully for transporting or terminating traffic when common costs are present. We therefore reject the arguments by some commenters that 'additional costs' may not include a reasonable allocation of forward-looking common costs.

[84] *See id.* at ¶ 1058.

paradigm."[85] As the Commission's proposals recognize, common costs comprise a significant portion of a firm's total costs when a firm provides multiple services,[86] and the Commission previously has voiced concerns regarding use of any cost methodology that "may not compensate carriers fully for transporting and terminating traffic when common costs are present."[87] The Supreme Court's approval of TELRIC rates as being "just and reasonable" underscores that the "additional cost" standard may be satisfied through the use of a methodology that accounts for joint and common costs.[88]

Replacing the existing incremental cost definition with another would generate a new round of legal challenges regarding whether the Commission's new incremental cost definition appropriately fulfills the "additional cost" provision articulated in Section 252(d)(2) of the Act. The proposal is contrary to the Act's requirement that universal service enable access to affordable, high-quality service in rural areas.[89] It also would undermine the Act's call for the Commission to encourage reasonable and timely deployment of advanced services to all Americans.[90]

If it adopts Windstream's proposed plan, the Commission would not have to confront these legal issues. The Commission can reduce rates now pursuant to its transitional authority under Section 251(g), which does not implicate the definition of "additional costs" under Section 252(d)(2). Or if it finds that Section 251(b)(5) governs the rates at issue, the Commission can continue to rely on the TELRIC standard in the

[85] *Id. at* ¶ 694.

[86] *Core Remand Order* App. A ¶ 248.

[87] *Local Competition Order* ¶ 1058.

[88] *See* Verizon Commc'ns Inc. v. FCC, 535 U.S. 467 (2002).

[89] 47 U.S.C. § 254(b).

[90] 47 U.S.C. §§ 157 nt, 254.

short term,[91] and then consider whether it should revise its interpretation of Section 252(d)(2) in a further notice of proposed rulemaking. A further proceeding could ensure that the Commission fully appreciates the implications of any change in course.

5. Any New Additional Costs Standard Should Account for Significant Variations in Switching Costs Incurred by Different Carriers.

If the Commission believes it needs a new additional costs standard, the Commission should seek additional comment to determine what the new standard should be, but in no instance should the new standard produce a uniform rate across all carriers. Given the differences in areas served by the RBOCs, wireless carriers, CLECs, and small and mid-sized ILECs, there is no reason to accept or conclude that the terminating costs for all of these different types of carriers within a state will be equal. This practice defies significant Commission precedent where the agency has recognized cost disparities in the context of universal service and intercarrier compensation.[92] Indeed, the *ISP Order on Remand* proceeding was a direct response to instances where the costs of terminating traffic varied between ILECs and CLECs that placed themselves between an ILEC and an Internet Service Provider.[93]

Even the proposals currently under consideration by the Commission recognize that different cost characteristics warrant different treatment. The proposals, albeit, do so in an arbitrary and relatively unsupported manner: They provide Alaska, Hawaii, and other territories and possessions a blanket carve out from intercarrier compensation

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[91] The Commission could rely on its general authority to adopt transitional measures to shield consumers and the industry from disruptions that might otherwise occur in the wake of "flash cut" reforms. *See, e.g., CompTel v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002) ("Avoidance of market disruptions pending broader reforms is, of course, a standard and accepted justification for a temporary rule.") (citations omitted).

[92] *See supra* note 62(citing several examples of this Commission precedent).

[93] *Core Remand Order* ¶ 3.

reform, with no explanation for how urban areas in these locales warrant special treatment as compared to rural, high cost areas in the continental United States.[94] Nevertheless the Commission could build upon this acknowledgement that cost characteristics of different carriers matter, and it could adopt measures to respond to cost characteristics of carriers in rural regions throughout the United States.

The draft orders' support for a uniform rate requirement reduces down to the assertion that the incremental cost of terminating services is near zero for all carriers. This assumption only holds under two scenarios. First, all carriers within a state will have the same, near zero cost if there are no longer any economies of scale in the telephone network. Second, the incremental cost for all carriers will be near zero if it is appropriate to disregard the vast majority of costs associated with termination services, because these costs are considered common to all voice traffic.

Neither of these scenarios is generally accepted as applicable to the telecommunications industry. The industry still is considered to be one characterized by a high degree of fixed costs.[95] And as noted above, the Commission has a longstanding practice of allocating joint and common switching costs across all services, including switched traffic.

The lack of justification for a near-zero, uniform rate is perhaps best indicated by the sources the Commission cites in support. The Commission does not reference its

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[94] *Id.* at App. A ¶ 191. Certainly Honolulu and Anchorage are not more costly to serve than, for example, Windstream's service territory in New Mexico, which stretches across the state and on average contains less than five subscribers per square mile.

[95] *See* Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 157, n.515 (rel. August 21, 2003) (finding there is a "very high proportion of joint and common costs and fixed costs" in the telecommunications industry).

prior intercarrier compensation or universal services decisions that have engaged in extensive reviews of switching costs, and have determined that carriers in rural regions incur substantially different costs than carriers able to take advantage of economies of scale in urban regions. To justify the amount of the rate, the Commission, instead, turns to sources of the likes of Wikipedia, self-described as "the free encyclopedia that *anyone* can edit"; a *Telephony Online* interview of a then-BellSouth employee in 2006; and an unpublished presentation, which its author says adopts "perhaps over-simple cost estimates . . . [to] derive some perhaps plausible insights about . . . the future of consumer pricing."[96]

B. The Lack of Meaningful Revenue Replacement for Mid-Sized Price Cap Carriers Is Unjustified and Would Result in Harm to Consumers Served by These Carriers.

The intercarrier compensation proposals under consideration would produce catastrophic reductions in intercarrier compensation revenues for Windstream and other mid-sized price cap carriers, without reasonable opportunities to replace these revenue reductions. The result would be a direct and significantly detrimental impact on rural customers' lives and livelihoods. If either of the intercarrier compensation reform proposals were adopted, Windstream and the other mid-sized carriers would not be in a position to deploy new broadband services to their customers, let alone maintain the prices and quality of services they offer to their customers today. Communications services for rural development and employment, public safety, modern health care, and education would be placed in jeopardy. This impact on its own should raise serious concerns for the Commission. In light of the largest financial crisis in 75 years,

[96] *Core Remand Order* App. A ¶ 261, n.688.

consideration of the intercarrier compensation reform proposals without the modifications proposed by Windstream should be a non-starter.

The Commission's intercarrier compensation reform proposals recklessly underestimate the negative impact they would have on mid-sized price cap carriers and the rural consumers they serve. Although the proposals recognize that reforms would result in reduced revenues for many carriers, they fail to grasp the effect or magnitude of the revenue reductions. Rather, the proposals brashly and incorrectly assert that mid-sized price cap carriers are using universal service funds to provide for "high overhead, sumptuous earnings, [and] rich dividends."[97] The proposals miss the mark by assuming that revenue shortfalls can and should be absorbed by implicit subsidies from other customers or unregulated products, or could be offset by reductions in dividends. If adopted, the proposals would produce some combination of the following consequences: Broadband expansion in rural communities served by mid-sized companies would slow substantially or cease; existing broadband deployment would be scaled back; the quality of existing voice and broadband services would be degraded; retail prices for rural consumers would increase substantially; and the pace and number of job reductions in rural communities would accelerate.

1. When Reducing Intercarrier Compensation Rates, the Commission Must – as It Always Has in the Past – Respond to Mid-Sized Carriers' Significant Need for Reasonable Opportunities to Replace Lost Revenues.

When previously taking steps to reform intercarrier compensation, the Commission has always recognized the need to provide carriers with reasonable opportunities to replace reductions in intercarrier compensation revenues, including SLC

[97] *Id*. at App. A ¶ 324.

increases <u>and</u> revenue replacement mechanisms.[98] The Commission, in fact, has been so sensitive to the impact of revenue reductions on carriers' ability to serve rural consumers that it has noted with concern that dramatic cuts in access charges "could result in a substantial decrease in revenue for incumbent LECs, which could prove highly disruptive to business operations" *even when accompanied by new explicit support mechanisms and changes to rates*.[99] There is no reason to be any less concerned about such dramatic changes today.

For a mid-sized price cap carrier like Windstream, the intercarrier compensation proposals under consideration by the Commission would result in unprecedented revenue reductions. Windstream's annual terminating intercarrier compensation revenues comprise roughly six percent of its $3.1 billion in annual revenues, or roughly $200 million. Significant reductions in these revenues, with insufficient opportunities for replacing them and no realistically obtainable opportunity for explicit universal service, would imperil Windstream and other mid-sized carriers' ability to serve their rural customers.

Although permitting a reasonable, moderate increase to the SLC cap is appropriate, affordable SLC increases alone will fall short of mid-sized carriers' needs. A reasonable recovery mechanism must be part of any significant intercarrier compensation reform. The mechanism need not guarantee "absolute revenue neutrality" for mid-sized carriers,[100] but it should be sufficient to ensure that these carriers are able to

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[98] *See, e.g., CALLS Order* ¶¶ 31-32; *MAG Order* ¶ 15.

[99] *Access Charge Order* ¶ 46.

[100] *Core Remand Order* App. A ¶ 325.

continue providing affordable, quality services in rural areas as required by Section 254 of the Act.[101] A wide array of parties support the need for such a mechanism.[102]

2. The Proposed Case-By-Case Opportunity for Revenue Replacement Is Woefully Inadequate and Would Discourage Further Broadband Deployment in Rural Areas Served by Mid-Sized Price Cap Carriers.

The proposals' case-by-case mechanism to review and consider the need for additional revenue recovery beyond available SLC increases is woefully inadequate and likely ephemeral. The undefined nature of the standard for relief and the process to obtain it would inject continued uncertainty into the business plans of the mid-sized price cap carriers. This uncertainty would plague their business model and dissuade vital private investment. By the time the Commission could make any decision about whether a price cap carrier is able to earn a "normal profit"[103] (even if a carrier could meet such a draconian standard), a mid-sized price cap carrier already would have suffered significant losses – both in terms of short-run reductions in intercarrier compensation revenues and liquidation of equity investment. This measure would provide too little relief, far too late to prevent significant harm to mid-sized price cap carriers and the rural customers they serve.

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[101] 47 U.S.C. § 254(b).

[102] *See, e.g.*, Letter from Larry Cohen, Communications Workers of America, President, to Kevin Martin, Chairman, FCC, WC Docket Nos. 06-122 and 05-337, CC Docket Nos. 96-45 and 01-92 (Oct. 27, 2008), at 3 (urging the Commission to "establish a supplementary explicit universal service fund available to mid-size carriers for broadband build-out"); Letter from Brian Mefford, Connected Nation, Chairman and CEO, to Kevin Martin, Chairman, FCC, WC Docket Nos. 06-122 and 05-337, CC Docket Nos. 96-45 and 01-92 (Oct. 27, 2008), at 2 (urging the Commission to establish universal service recovery mechanisms that "should be available to all carriers of last resort, regardless of company size, structure or regulatory classification"); Letter from Walter McCormick, USTelecom, President, to Kevin Martin, Chairman, FCC, CC Docket No. 01-92 (Oct. 10, 2008), at 5, 7, 8 (declaring that "establishment of a credible and compensatory ARM is an essential element of comprehensive intercarrier compensation reform"); Letter from Curt Stamp, ITTA, President, to Secretary Dortch, Secretary, FCC, CC Docket No 01-92 (Sept. 19, 2008), at 5 (recommending that mid-sized carriers be able to use an Alternative Recovery Mechanism); Missoula Plan Ex Parte Letter.

To conclude that an Alternative Recovery Mechanism is not needed, the proposal makes the observation that marketplace developments have resulted in new revenue opportunities for carriers.[104] While it is true that new opportunities exist, the Commission ignores the other side of the equation: Marketplace developments also have resulted in substantial reductions to revenues from traditional local voice products. The incremental revenues from new services and business opportunities are barely keeping pace with the amount of retail and wholesale revenues lost annually to competitors and other sources. Thus, most mid-sized price cap carriers have flat to slightly declining revenues year-over-year, as they replace local voice revenues with revenues from new sources like broadband.[105]

Moreover, the proposed methodology for revenue replacement contradicts the letter and intention of Section 254 of the Act. There Congress directs the Commission to make implicit universal service support explicit, and to ensure that this support provides sufficient funding for carriers serving high-cost, rural areas that are otherwise uneconomic to serve.[106] But rather than eliminating implicit support and making it explicit as the Act requires, the proposals would create new implicit support mechanisms by requiring carriers to cross-subsidize the supported services they are required to provide as Eligible Telecommunications Carriers and carriers of last resort with unregulated services that they are not required to provide. This measure would

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[103] *See Core Remand Order* App. A ¶ 323.

[104] *Id.* at App. A ¶ 313.

[105] For example, Windstream's *total* revenues – which include voice, broadband, and video (i.e., from DISH TV) – are flat or declining in recent years.

[106] Congress recognized that the introduction of competition would up-end regulators' historical reliance on implicit cross-subsidization to support affordable service by carriers of last resort in high-cost areas. *See CALLS Order* at ¶¶ 21-25 (describing Congressional intent).

discourage carriers from investing in the very services – like broadband and VoIP – that the Commission's proposals assert they intend to encourage.

3. The Current Broken Universal Service Fund Cannot Be Relied on as a Safety Net.

Existing federal universal service support offers little consolation to mid-sized price cap carriers. A common misconception is that all of these carriers, including Windstream, are funded largely by federal universal service support or rely heavily on such support to pay dividends to private investors. That simply is not the case. The outdated federal universal service mechanisms provide a disproportionately large amount of support to small, and even some mid-sized, rate of return carriers, but do not provide adequate support to mid-sized price cap carriers serving high-cost rural areas. Due to averaging of costs and inconsistencies between high-cost support calculations and rate regulations, the universal service system fails to target support directly to high cost areas where it is needed most. Consequently, Windstream – with 27 percent of its exchanges comprised of 500 access lines or less – receives less than 1 percent of its total annual revenues from high-cost loop and model support, and less than 3 percent of its total revenues from all federal high-cost support combined.

4. The Commission's Proposals for Revenue Replacement Break the Commission's Long Held Policy of Encouraging Price Cap Regulation and Arbitrarily Favor Rate of Return Carriers.

The Commission's proposals inexplicably break with the Commission's long held policy of encouraging price cap regulation. The proposals favor rate of return carriers with special treatment for revenue replacement.[107] They even go so far as providing a

[107] *See, e.g.*, *Core Remand Order*, App. C.

new path for price cap carriers to make a one-time election back to rate of return regulation.[108]

These proposals are contrary to the public policy interests recognized repeatedly by the Commission in the past. As the Commission explained in the *LEC Price Cap Order*, price cap regulation "permit[s] LECs to migrate their rates toward a set of prices that enhances efficiency"[109] and rewards "companies that become more productive and efficient."[110] This productivity and efficiency ultimately benefits consumers. Price cap regulation produces these public interest benefits while using fewer regulatory and administrative resources to police carriers than are required to prevent the misallocation of costs under rate of return regulation.[111] Price cap regulation also can stimulate residential and business customer demand for telecommunications services.[112] More efficient use of and greater demand for the nationwide telecommunications network, in turn, contributes to overall economic growth by reducing the cost of telecommunications services that are used by other industries to produce goods and services.[113]

The Commission's proposals provide no rational basis for this sudden change in policy. Indeed, favoring rate of return carriers in this context is arbitrary and does not

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[108] *Core Remand Order* App. A ¶ 324.

[109] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, ¶ 35 (rel. Oct. 4, 1990, cor. Oct. 31, 1990) ("*LEC Price Cap Order*").

[110] *Id*. at ¶ 1.

[111] *See id*. at ¶ 34 ("Previous orders in this docket have articulated the pressures that a rate of return system places on cost allocation systems. . . . Indeed, given the incentives rate of return creates for companies to misallocate costs, thereby threatening our policy of ensuring that rates are based on their fully distributed costs, we spend a great deal of our regulatory resources policing our cost allocation systems. Under incentive regulation, prices would no longer be set by reference to a set of fully distributed costs. . . . Incentive regulation, by in large measure removing the incentive to misallocate costs between services, may mitigate misallocation as a regulatory concern.").

[112] *Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, ¶ 2 (rel. Apr. 7, 1995).

accurately reflect regulatory structures in place in many state jurisdictions. These deficiencies are especially apparent in how the proposals approach offsetting intercarrier revenue reductions with universal service support.[114] Under the proposed mechanism, a carrier operating under federal price cap regulation could attain such support only after a review of all its revenues and costs (including non-regulated), but no such review would be required of carriers operating under federal rate of return regulation.

The Commission's proposals base this disparate treatment on at least two incorrect conclusions. First, the proposals baldly assert that different treatment is warranted for price cap carriers, because these carriers pay dividends and use the same network to provide regulated and deregulated services.[115] Both price cap and rate of return carriers, however, engage in these legitimate practices.

Second, the Commission's proposals ignore that the regulatory treatment of carriers in the federal jurisdiction often does not match the regulatory framework at the state level. The proposals assert, without further explanation, that "differences are warranted by the different rate regulation frameworks"[116] and that "interstate rate-of-return carriers present a special situation."[117] This assertion, however, does not hold up with respect to many intrastate rates. Like the Commission, many states have adopted alternative regulation plans (i.e., price cap like plans) that no longer subject carriers to an earnings test, and provide incentives for carriers to become more efficient and retain the

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[113] *Id*. at ¶ 3.

[114] *Core Remand Order* App. A ¶ 314; App. C ¶ 312.

[115] *Core Remand Order* App. A ¶ 314.

[116] *Core Remand Order* App. A ¶ 324.

[117] *Core Remand Order* App. C ¶ 320.

resulting savings.[118] Thus, in many instances, carriers operating under rate of return regulation at the federal level may be rate regulated at the state level in exactly the same manner as a carrier that is price cap regulated at the federal level. There is simply no basis for treating a federal rate of return carrier differently with regards to intrastate access reductions resulting from the proposals than a federal price cap carrier especially when both are often regulated as price cap carriers in the state jurisdiction. Yet the Commission's proposals would provide such carriers with very different federal recovery mechanisms to replace mandated reductions in intrastate access revenues.

IV. PROPOSED REFORMS TO THE UNIVERSAL SERVICE MECHANISM ARE INADEQUATE AND COULD EXACERBATE EXISTING PROBLEMS WITH HIGH-COST SUPPORT.

Although Windstream is the largest independent communications provider focused primarily on rural areas,[119] Windstream does not receive a significant amount of funding under the current high-cost system relative to its overall revenues.[120] This gap between funding needed and funding received is reflective of larger problems with the high-cost mechanism. As Windstream has described in detail in past comments,[121] which it incorporates by reference here, the current universal service high-cost system does not accomplish the goals set out in Section 254 of the Act.[122] The Commission's program

[118] For example, in South Carolina most carriers have elected to operate under an alternative form of regulation, in Georgia 27 of 35 small rural companies also operate under an alternative form of regulation. In some states like Alabama, Arkansas, and Kentucky all carriers have elected to operate under an alternative regulation plan. Some states, like New Mexico, have completely eliminated rate of return regulation.

[119] With an average subscriber density of approximately 20 access lines per square mile, Windstream offers telecommunications services to 3.1 million access lines across 16 states.

[120] Windstream receives less than 1% of its total revenue from high-cost loop and model support, and less than 3% of its total revenues from all federal high-cost support combined.

[121] *See, e.g.*, Windstream USF Comments.

[122] Section 254 of the Communications Act articulates principles that should serve as the basis for the Commission's "policies for the preservation and advancement of universal service."[122] These principles

plainly fails to target sufficient and predictable high-cost support directly to high-cost areas. It provides too much support to some ILECs and not enough to others, all without an objective way to assure service is affordable to consumers. These flaws are to the detriment of all consumers paying for universal service, and in particular to the detriment of rural consumers living in areas served by underfunded carriers.

Windstream continues to urge the Commission to take action now to bring the existing high-cost system in line with the universal service principles adopted in Section 254 of the Act. The federal system is in need of significant reform, and none of the proposals adequately address its problems. Instead of pushing off the difficult task of reforming universal service, the Commission should enact reforms now that ensure fair, rational, and targeted allocation of universal service funds to the benefit of rural consumers regardless of the size of the carrier that happens to serve them.

A. The Proposal to Condition Receipt of Existing Universal Service Support on a Carrier's Ability to Offer Ubiquitous Broadband Would Unduly Benefit Overfunded Carriers, While Jeopardizing the Broadband Deployment Efforts of Underfunded Carriers That Serve Truly High-Cost Areas.

Windstream does not support the proposal to condition receipt of universal service funds on making a commitment to offer broadband service throughout the supported study area within five years. Although it holds out the promise of identifying areas that require additional support for severely underfunded carriers like Windstream,

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include, among others, (i) "specific, predictable, and sufficient" support should be provided "to preserve and advance universal service"; (ii) "quality services should be available at just, reasonable, and affordable rates"; and (iii) consumers in "all regions of the Nation" should have access to telecommunications and information services at "reasonably comparable rates." 47 U.S.C. § 254(b). The Commission repeatedly has recognized that these principles should guide its allocation of high-cost support. *See, e.g., Identical Support Rule NPRM* at ¶ 2 (recognizing "Section 254(b) of the Communications Act of 1934, as amended, (the Act) directs the Federal-State Joint Board on Universal Service (Joint Board) and the Commission to base policies for the preservation and advancement of universal service on several general principles"); *Joint Board Comprehensive Reform NPRM* at ¶ 2 (same); *Reverse Auctions NPRM* at ¶ 2 (same).

this measure will continue to support many small, rural ILECs that are able to meet the commitment only because they have been and will continue to be overfunded by the high-cost fund. At best, this reform has the potential to highlight the areas that need more support to make such a commitment, but lacks sufficient specificity about how much support would be needed and how such support would be distributed.

Many carriers, including Windstream, would be unable to make such a commitment and would see their existing universal service support placed at risk. In Windstream's case, the significant amount of capital investment and ongoing operational expenses required to meet the commitment would far outweigh the amount of high-cost support it receives. Windstream currently receives approximately $82 million in federal high-cost support. This amount pales in comparison to the funding required to offer broadband to Windstream's approximately 450,000 customers who currently do not have access to this service: Windstream previously has estimated that it would cost $250 to $400 million to deploy broadband facilities to these customers,[123] and it then would need to spend many millions more on ongoing broadband operating costs.[124] Windstream would have to forgo high-cost support if that support was conditioned on incurring these capital and operating expenses.

Significant uncertainties, consequently, would plague Windstream's business plans and hinder its ability to maintain private investment and continue its broadband deployment initiatives. The Commission would subject the carrier's support to reverse

[123] Windstream USF Comments 13-14 (this capital expense projection is based upon offering broadband at speeds ranging from 768 Kbps to 1.5 Mbps).

[124] *Id*. at 14-15 (such operating costs encompass, but are not limited to, transport fees that Windstream must pay to connect island exchanges to the Internet backbone; additional customer call center staffing required to support broadband products; creation and maintenance of a system that tracks the provision and capacity

auctions. If there is no bidder, it is not clear what steps the Commission would take next. The proposed order merely provides that the Commission "will reexamine any such study area to determine whether the frozen high-cost support amount is sufficient," without explaining the basis for that determination. If it finds that support is not sufficient, the proposal states that the Commission would take further undefined steps, such as possibly disaggregating the study area on a wire center basis or increasing the reserve price. Again, the proposal fails to specify how these steps would be accomplished, or reconciled with a cap placed on total high-cost support. Given the Commission still has not been able put forward a satisfactory definition of the term "sufficient" for purposes of Section 254,[125] it is not adequate for the Commission to put off for another day the task of sorting out these critical questions.

B. To Realize Ubiquitous Broadband Deployment, Policymakers Will Need to Dedicate Substantial Additional Funding to Carriers Serving High-Cost Areas.

Windstream shares the Commission's goal of ubiquitous broadband deployment and has consistently urged the Commission to develop policies that encourage broadband deployment where economically feasible and boost consumer adoption where broadband already has been deployed.[126] Windstream has invested hundreds of millions of dollars to aggressively deploy broadband to consumers in its service territory. This commitment has resulted in an industry-leading penetration level of its customers who can and do subscribe to broadband. Specifically Windstream currently is able to reach

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of each existing Digital Subscriber Line Access Multiplexer; grooming of cable pairs; and installation of jumpers to connect a phone line to broadband equipment).

[125] *See* Qwest Corporation v. FCC, 398 F.3d 1222, 1233 (10th Cir. 2001) (holding that the Commission failed to reasonably define the term "sufficient").

[126] Windstream USF Comments 12.

approximately 85 percent of its total customer base. Of those residential customers that can purchase Windstream's broadband service, 48 percent actually subscribe. Speeds offered by Windstream are at least 1.5 Mbps, and can go up to 12 Mbps. This record is particularly impressive in light of the rural, high-cost nature of Windstream's service territory – approximately 20 subscribers per square mile – and the relatively little high cost support it receives.

Sharing the Commission's goal of broadband ubiquity, however, does not mean that Windstream will be able to achieve this goal on its own. The combination of high capital and operational costs with few customers to offset those costs makes it especially challenging to meet business plan objectives. Moreover, continued receipt of existing high-cost support is insufficient to offset these costs. As noted above, Windstream currently only receives approximately $82 million – an amount far less than the $250 to $400 million it would need to incur in up-front capital costs, and the many millions more that it would need to incur in ongoing operating costs.

If broadband providers are to assume such costs in the near term,[127] additional funds will be required to provide adequate returns on the associated investments. In part this additional funding can come from retargeted, existing high-cost support. As Windstream has proposed previously, the Commission could place all price cap companies under a forward-looking mechanism, and reform the "non-rural" mechanism to eliminate eligibility requirements based on statewide average costs.[128] These reforms in and of themselves will improve the economics for deploying broadband in high-cost

[127] Although no one can predict what the future holds with confidence, it is likely that technological advances will improve broadband providers' ability to deploy broadband deeper into their networks and at greater speeds. For example, Windstream this year was able to double the available speeds for some of its broadband connections due to a technological advancement.

areas that are otherwise too expensive to serve. As support is recalculated and retargeted, many high-cost areas that are currently uneconomic to serve because of the costs associated with shortening loops and otherwise upgrading dual-use plant, will receive additional funding. This targeted high-cost support would improve the economics for broadband deployment in many such areas that are currently uneconomic to serve.

To address rural areas where funding will remain insufficient, the Commission should take steps now to model the cost of making broadband available to all consumers. It makes no sense, as proposed by the Commission, to delay this measure until after reverse auctions have been unable to attract bidders. Designing and implementing the reverse auctions process could take years to complete, while in the meantime carriers would be cautious or discouraged from deploying broadband due to the uncertainty of continued funding. This unnecessary delay should be avoided. A better approach would be to determine the proper amount of universal service funding required to build and operate a ubiquitous broadband network. By using a forward-looking model with proper network inputs and design, the Commission would be able to ascertain the amount of additional funds required for carriers to deploy ubiquitous broadband services.

C. In Conjunction With Fundamental Reform of the High-Cost Mechanism, the Commission Should Cap High-Cost Support for Both the Total Fund and Individual Lines.

Windstream supports a cap on total high-cost universal service as a means to address sustainability of the fund, so long as that cap is accompanied by fundamental reform of the high-cost mechanism. The Commission must not merely freeze in place the current levels of high-cost support distributed under existing rules, as is largely proposed

[128] Windstream USF Comments 4-11.

by Appendix A and C of the FNPRM.[129] Rather, the Commission should objectively identify actual high-cost areas and then should target the support under the total cap to those areas on an equitable basis. Moreover, any cap on the total fund should not apply before taking into account any new explicit universal service support needed to offset the loss of implicit support from intercarrier compensation reform.[130]

Windstream also would support the use of reverse auctions to further reduce the level of total funding and promote efficiency. All three of the FNPRM proposals, however, fail to meet this condition. A significant flaw with the FNPRM proposals is that setting a reserve price based on existing levels of support will not result in meaningful bidding in truly high-cost areas where currently there is too little or no high-cost support. As noted above, the Commission's proposals do not specify how the agency will respond to instances when auctions for such areas employ a reserve price that is too low to attract serious bidders.

Finally, Windstream recommends that the Commission set an additional cap on per-line high cost support. It makes little sense for the Commission to cap the overall fund but to continue allowing carriers to receive per-line support amounts at unchecked levels. Certainly, at some level, one has to question the rationale for providing telecommunications service to consumers regardless of the cost. Just as there should be a cap on the total size of the fund to ensure sufficiency and affordability, the Commission should set a maximum amount beyond which the universal service program provides no further support.

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[129] *Core Remand Order* App. A ¶ 30.

[130] The Commission, however, may deem it appropriate to set a separate target for the explicit support, as it did for Interstate Access Support.

V. THE PROPOSED LIFELINE/LINK UP PILOT PROGRAM FAILS LOW-INCOME, RURAL CONSUMERS.

Windstream was pleased to see the Commission propose "to examine how the Lifeline and Link Up universal service support mechanism can be used to enhance access to broadband Internet access services for low-income Americans."[131] Windstream has consistently and repeatedly urged federal policymakers to give serious consideration to using Lifeline and Link Up dollars to increase broadband adoption.[132] Any meaningful USF support for broadband must address the needs of low-income consumers who cannot afford to purchase broadband service. As Windstream Chief Executive Officer Jeff Gardner explained before Commissioners Michael J. Copps and Jonathan S. Adelstein at a U.S. Senate Commerce Committee field hearing last year, "[t]he gap between those consumers who are online and offline more and more is defined by their economic, rather than geographic, conditions."[133]

The Commission's stated goals for the Lifeline/Link Up Pilot Program suggest that it recognizes the potential, widespread benefits that could be realized with such a program. The Commission declares that all qualifying low-income consumers should be able to receive broadband discounts, "limited only by the availability of funds."[134] It also asserts that the design of the Pilot Program "comports with" Section 254(b)(2)'s instruction that the Commission base policies for the advancement of universal service on

[131] *Core Remand Order* App. A ¶ 64.

[132] *See, e.g.*, Windstream USF Comments 18; Letter from Eric Einhorn, Vice President Governmental Affairs, Windstream Communications Inc., to Marlene Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 99-68, 08-122, 05-337, 08-152 (Sept. 24, 2008).

[133] Written Testimony of Windstream President and Chief Executive Officer Jeff Gardner, U.S. Senate Committee on Commerce, Science, and Transportation Field Hearing: The State of Broadband in Arkansas 5 (Aug. 28, 2007).

[134] *Core Remand Order* App. A ¶ 85.

the principle that "[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation."[135]

The Commission's specific plan for the Lifeline/Link Up Pilot Program, however, falls short of its potential and the Commission's stated objectives. Without modification, the Pilot Program will do little to promote broadband access to low income consumers residing in high-cost, rural areas. The proposed carrier eligibility criteria and distribution mechanism would make it difficult, or more likely altogether cost prohibitive, for many rural broadband providers to participate. Many low-income, rural consumers, in turn, would have no opportunity to benefit from the Pilot Program, due to lack of participating providers in their regions.

A. To Afford Rural Consumers a Meaningful Opportunity to Benefit From Broadband Discounts, the Commission Should Not Condition Pilot Program Participation on A Broadband Provider's Ability to Offer Broadband Service to All Customers in Its Service Territory.

The requirement for a participating broadband provider to offer "services and supported devices . . . throughout its service areas"[136] would unduly penalize broadband providers serving truly high-cost regions. Windstream's experience indicates that it is both economically and technically infeasible for companies to deploy broadband in the next few years to all residents in truly high-cost regions. Consequently many rural broadband providers, and many low-income consumers in their service territories, would be unable to participate in the Pilot Program.

Windstream, in particular, could not justify spending the gargantuan sums required to meet the ubiquitous broadband deployment obligation, in the hope of

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[135] *Id.* at App. A ¶ 72 (citing 47 U.S.C. § 254(b)(2)).

[136] *Id.* at App. A ¶ 87.

obtaining discounts for a limited number of low-income consumers in its service area. As indicated in Section IV.A above, Windstream estimates that it would cost the company somewhere between $250 and $400 million to deploy broadband to reach the approximately 450,000 customers who still do not have access to its broadband.[137] Capital costs are all the more staggering when placed within the context of the number of customers a company currently could expect to gain from new broadband deployment. Assuming a take rate of 30 percent, Windstream expects its capital costs, on average, to exceed $1,800 for each new broadband customer brought onto its expanded network.[138] Windstream then would need to spend millions more each year on ongoing broadband operating costs.[139] The potential to benefit from Pilot Program participation is insufficient to offset these substantial costs.

And even if it could justify the costs, Windstream nevertheless would not be able to build out its network in the timeline required for participation in the Lifeline/Link Up Pilot Program. Windstream, with full funding, estimates that it would take *three* years, if not more, for it to deploy broadband to its approximately 450,000 unaddressed customers. Efforts to bring unaddressed customers online would be very time and resource intensive. To bring these customers onto its broadband network, Windstream would need to shorten copper analog loops between customers' homes and their serving Digital Subscriber Line Access Multiplexers ("DSLAMs") because Windstream's

[137] Windstream USF Comments 13-14 (this capital expense projection is based upon offering broadband at speeds ranging from 768 Kbps to 1.5 Mbps).

[138] This figure does not account for additional associated operating and acquisition costs.

[139] *See* Windstream USF Comments at 14-15 (such operating costs encompass, but are not limited to, transport fees that Windstream must pay to connect island exchanges to the Internet backbone; additional customer call center staffing required to support broadband products; creation and maintenance of a system that tracks the provision and capacity of each existing Digital Subscriber Line Access Multiplexer; grooming of cable pairs; and installation of jumpers to connect a phone line to broadband equipment).

customers who are outside of the company's broadband footprint typically reside in areas furthest away from Windstream's broadband serving devices.

Given these technical and economic limitations, the Commission must eliminate the ubiquitous broadband build out obligation if it truly intends to permit low-income customers "in all regions" to participate in the Pilot Program. Otherwise rural, low-income customers will be left without any options for participating providers – a result contrary to universal service goals adopted by Congress and the Commission's stated objectives for the Pilot Program.[140]

B. Limited Pilot Program Funding Should Not Be Administered to Low-Income Consumers on a First-Come, First-Served Basis, Since This Approach Likely Would Not Result in a Proportionate Distribution of Support to Rural Consumers.

Distributing the limited Lifeline/Link Up Pilot Program funds on a "first-come, first-served basis" will not provide for a proportional share of funding for rural, low-income consumers.[141] Under a first-come, first-served regime, broadband providers would find themselves in a race to sign up customers, but the customers in rural markets will be more difficult and costly to reach. Broadband providers in urban areas can readily employ concentrated media marketing programs to reach millions of customers. In contrast, rural providers have little scale to use radio and television communications to promote available discounts. Often it is altogether economically infeasible to use mass

[140] *See* 47 U.S.C. § 254(b) (articulating principles serving as the basis for "policies for the preservation and advancement of universal service," which include, but are not limited to, (i) "[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation" and (ii) "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to . . . information services . . . that are reasonably comparable to those services provided in urban areas . . . .").

[141] *Core Remand Order* App. A ¶ 85.

media in rural areas.[142] Rural broadband providers, instead, must resort to using bill inserts, which are expensive and less likely to have an immediate impact as compared to repeated mass media advertisements aired over a short time period. Given these rural advertising challenges, the first-come, first served scheme would disadvantage rural consumers whose broadband providers would be hindered relative to urban providers that can most easily direct resources to "winning" the broadband marketing race.

Using a "first come, first served" basis for distributing funds would mean that discounts effectively would be directed away from regions where broadband adoption is needed most: rural areas. As acknowledged by proposed Commission orders, "[b]roadband Internet access plays a special role in rural areas, reducing the burdens of distance":

> For example, high-speed connections to the Internet allow children in rural areas to have access to the same information as school children in urban areas. Telemedicine networks made possible by broadband Internet access service also save lives and improve the standard of healthcare in sparsely populated, rural areas that may lack access to the breadth of medical expertise and advanced medical technologies available in other areas.[143]

The role of broadband in rural areas is particularly important for low-income, rural residents, who may have little resources available to supplement their children's

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[142] Advertisers purchase mass media advertising for designated market areas ("DMAs"), or regions where consumers receive the same television or radio station offerings. DMAs can stretch over wide swaths of both urban and rural areas, so a carrier hoping to use mass media to reach a small number of rural consumers may have to assume the cost of advertising to a large number of urban consumers as well. Wasted mass media advertising dollars in this instance can be significant. For example, for Windstream to advertise to Canton, Monroe, and Widener, Georgia, it would have to purchase mass media for the entire Atlanta DMA, when only 8 percent of individuals in the DMA reside within Windstream's service territory.

[143] *Core Remand Order* App. A ¶ 22.

classroom learning and who may not be able to afford travel for medical care. Broadband also is critical for supporting commerce and jobs in rural areas.[144]

Using Lifeline/Link Up funds to increase the pool of potential broadband subscribers in rural areas also may drive further broadband deployment in rural areas. Currently only 38 percent of rural households subscribe to broadband service, as compared to the 57 percent and 60 percent of households in urban and suburban areas, respectively.[145] Increasing rural demand for broadband could, in turn, spur increased supply. While the potential for Lifeline/Link Up broadband subscribers certainly will not make it economic to deploy broadband in all locations over time, the presence of a larger number of expected subscribers may tip the scale in favor of building out broadband networks in some areas that previously failed to meet business case objectives.

Given the special need to ensure broadband discounts are available in rural areas, the Commission should earmark 50 percent of all Pilot Program funding to qualified low-income consumers residing in rural regions. This measure would ensure that sufficient funds are allocated for low-income consumers in rural areas, which should include any area that qualifies as "rural" for the purposes of administration of the U.S. Department of Agriculture's Broadband Access Loan program.[146] Implementing the Pilot Program in

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[144] *Id.* at App. A ¶ 22 (quoting Broadband Data Improvement Act, Pub. L. No. 100-385, 122 Stat. 4096, § 102(1)–(2) (2008)).

[145] *See* 2008 PEW BROADBAND ADOPTION STUDY at 3–4 (reporting the findings of a survey conducted from April 8, 2008 to May 11, 2008 among 2,251 American adults, 1,153 of whom were broadband users).

[146] *See* 7 U.S.C. § 1991(a)(13) (in general defining "rural" as the following: "any area other than-- (i) a city or town that has a population of greater than 50,000 inhabitants; and (ii) any urbanized area contiguous and adjacent to a city or town described in clause (i)"). Alternatively the Commission, for ease of administering the Pilot Program, could define a "rural" area as any study area served by a "rural telephone company," as defined by 47 U.S.C. § 153(37). *See Federal-State Joint Board on Universal Service*, FCC 97-157, CC Docket No. 96-45 (rel. May 8, 1997) at ¶ 310 (defining "rural carriers" as "those carriers that meet the statutory definition of a 'rural telephone company'"). Windstream does not prefer this approach, because as it has noted on multiple occasions, a region should be designated as "rural" due to the characteristics of the individual region, rather than the size (or study) area of telecommunications company

this manner would best respond to Congressional calls for universal service to ensure, in particular, that consumers who are "low-income . . . and . . . in rural, insular, and high cost areas . . . have access to . . . information services . . . that are reasonably comparable to those services provided in urban areas. . . ."[147]

C. Requiring Small and Mid-Sized Broadband Providers to Offer a "Wide Array" of Broadband Internet Devices Would Be Unduly Burdensome and Might Limit These Providers' Ability to Secure Bulk Discounts.

The Commission should not condition Pilot Program participation on whether a broadband provider makes "available a wide array of cost efficient broadband Internet access devices . . . ."[148] This proposed requirement would unduly favor larger, integrated carriers that are more likely to have existing relationships with equipment manufacturers, and a customer base large enough to justify bulk discounts across a variety of products. In contrast, small and mid-sized carriers, with fewer resources at their disposal, would have more difficulty shouldering the administrative burden of offering a wide array of devices. The requirement also might make it more difficult for small and mid-sized carriers to secure bulk discounts for individual devices.

VI. THE COMMISSION SHOULD REPLACE THE EXISTING UNIVERSAL SERVICE CONTRIBUTIONS METHODOLOGY, WHICH IS BASED ON REVENUES, WITH A TELEPHONE NUMBER-BASED METHODOLOGY.

Windstream supports replacing the existing universal service contribution methodology, which is based on revenues, with a methodology based primarily on telephone numbers. Changing conditions in the telecommunications marketplace have

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serving it. *See, e.g.*, Reply Comments of Windstream Communications, Inc., WC Docket No. 05-337, CC Docket No. 96-45, at 4 (filed July 2, 2007).

[147] 47 U.S.C. § 254(b)(3).

challenged the current methodology. First, interstate retail revenues continue to decline.[149] This decline, coupled with an increase in universal service disbursements, has placed upward pressure on the contribution factor and jeopardized the sustainability of universal service support. Second, technological changes and the rising popularity of "all-you-can-eat" service plans has made it more difficult to assign revenues to jurisdictions in a meaningful manner.[150] There can be significant ambiguity as to whether revenues qualify as assessable interstate or international end-user telecommunications revenues. Transitioning to a numbers-based methodology, however, will reduce these issues by simplifying reporting, establishing a sustainable contribution base, and providing for a more transparent assessment to customers.

Concurrent with universal service reforms, the Commission should conform the methodology used for all the other funds that use Form 499 – e.g., TRS, NANPA and Local Number Portability – to the new methodology employed for universal service. Carriers should not be required to continue reporting revenues in the Form 499 in addition to information required by the new methodology. The logic for eliminating

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[148] *Core Remand Order* App. A ¶ 90.

[149] *See id*. App. A ¶ 91 ("The total assessable revenue base has declined in recent years, however, from about $79.0 billion in 2000 to $74.5 billion in 2006, while universal service disbursements grew over that same time period from $4.5 billion in 2000 to over $6.6 billion in 2006."). Some recent reforms, however, have partially offset pressure placed on sustainability of the fund. These reforms include increasing the wireless safe-harbor and requiring interconnected VoIP providers to make USF contributions. *See Universal Service Contribution Methodology; Federal-State Joint Board on Universal Service; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms; Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990; Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size; Number Resource Optimization; Telephone Number Portability; Truth-in-Billing and Billing Format; IP-Enabled Services*; Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518, ¶ 2.

[150] *Core Remand Order* App. A ¶ 92 (finding that "interstate end-user telecommunications service revenues are becoming increasingly difficult to identify as customers migrate to bundled packages of interstate and intrastate telecommunications and non-telecommunications products and services").

revenue-based reporting for universal service contributions applies with equal weight to contributions for these other programs. In addition, maintaining revenue-based reporting in Form 499 for non-universal service mechanisms would present undue administrative complications if the Commission moved to a numbers-based regime for universal service.

Consistent with the Commission's proposal, Windstream also recommends that the Commission provide exemptions from universal service assessments only when individuals "are truly unable to bear the burden of contributing to the universal service fund . . . ."[151] By limiting exemptions to Lifeline customers and customers purchasing stand-alone voicemail services, the Commission appropriately balances dual Congressional goals: It guarantees universal service support mechanisms are "specific and predictable," while ensuring "low-income consumers. . . have access to telecommunications and information services."[152]

In the event the Commission decides to adopt a hybrid mechanism that combines telephone numbers with another basis for assessment, Windstream agrees with AT&T and Verizon that a numbers/connections approach is preferable to the transitional numbers/revenues proposal currently under consideration.[153] A hybrid methodology that uses connections, which can be clearly categorized as intrastate or interstate, would be easier to administer and could be adopted immediately. Moreover, Windstream supports limiting the number of connection tiers to further simplify reporting and contribution requirements. AT&T and Verizon's recommended approach, which identifies two tiers

[151] *Id.* at App. A ¶ 140.

[152] 47 U.S.C. 254(b).

[153] Letter from Mary L. Henze, AT&T Services, Inc. & Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket 06-122, CC Docket No. 96-45, 1 (filed Oct. 20, 2008).

of connections and assesses different USF surcharges to each,[154] would provide this simplification in a manner that appropriately responds to the desire to account for user demand when assessing surcharges.

VII. CONCLUSION

Reform of intercarrier compensation and universal service is a worthwhile, but complex, endeavor. As the Commission has recognized in the past, these policies raise issues that are difficult to address with "one stroke of the sword."[155] The Commission, however, can make substantial progress toward fulfilling the Act's goals by adopting a more fair and balanced approach – such as suggested by Windstream, ITTA, or USTelecom – that addresses areas where the Commissioners have identified a "growing measure of consensus."

Respectfully submitted,

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Dated: November 26, 2008

Its Attorney

[154] *Id*. at 2. A $5 surcharge would be assessed to the low bandwidth connection, as compared to a $35 surcharge assessed on the high bandwidth connection. *Id*.

[155] *CALLS Order* ¶ 26.

APPENDIX A

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Ms. Marlene H. Dortch
Secretary, Federal Communications Commission
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Re: Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; High-Cost Universal Service Support, WC Docket No. 05-337; Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Universal Service Contribution Methodology, WC Docket No. 06-122; Intercarrier Compensation for ISP-Bound Traffic, WC Docket No. 99-68; Petition of AT&T for Declaratory Ruling and Limited Waivers Regarding Access Charges and "ESP Exemption," WC Docket No. 08-152; Establishing Just and Reasonable Rates for Local Exchange Carriers, WC Docket No. 07-135

Dear Ms. Dortch:

Windstream is very concerned that the intercarrier compensation reforms under consideration will jeopardize mid-sized price cap carriers' ability to continue providing affordable, quality broadband and voice services in rural areas. If they are forced to incur sizable losses in intercarrier compensation revenues, mid-sized price cap carriers will not be in a position to deploy new broadband services to their customers, let alone maintain the prices and quality of services currently offered to their customers today. These carriers' communications services are critical for rural development and employment, public safety, modern health care, and education. Thus, adoption of this proposal could have a direct and significantly detrimental impact on rural customers' lives and livelihoods. This impact on its own should raise serious concern for the Federal Communications Commission ("Commission"). When considered in light of the largest financial crisis in 75 years and during what appears to be a serious global recession, the intercarrier compensation reform proposal should be a non-starter as written.

Given these substantial concerns, Windstream requests that the Commission put its intercarrier compensation reform proposal out for comment. Alternatively, if the Commission believes it must take additional steps to address comprehensive intercarrier compensation reform now, the Commission should take a more measured approach by adopting together interrelated modifications to the plan, as suggested below.

I. Private Investment Is Needed to Support Voice and Broadband Services in Rural Areas.

To provide affordable, quality broadband and voice services to rural consumers, mid-sized carriers, like Windstream, rely on private investment. Private investors enable these carriers – among other items – to service debt, finance broadband deployment, and otherwise remain fiscally sound. Such investors look for stability in the mid-sized carrier's financial position and outside influences, including the regulatory structure and economic environment.

The stability of a mid-sized carrier's business model is particularly important to the type of investors it attracts. These investors – which include many public employee pension funds and insurance companies[1] – are drawn to mid-sized carriers due to their historic cash flows, ability to pay dividends regularly, and consistent levels of profitability.[2] Thus, any significantly negative change to the mid-sized carrier's business model could trigger a mass exodus in private investment, which would impair these carriers' ability to fulfill central public policy goals of the Communications Act. Mid-sized carriers would struggle to maintain "reasonably comparable rates" and "quality services," and would have to curtail plans for further deployment of advanced services.[3]

If confidence in the viability of the mid-sized rural business model is undermined, it will be too late for the Commission to unring that bell. Investors will not wait around to see if the Commission comes to the rescue and how. To prevent this outcome, mid-sized carriers, if at all possible, will have no choice but to try to maintain their investors' returns by raising prices, and decreasing spending on their networks and operations.[4] And if these measures are not sufficient to retain private investment, the Commission will face a new challenge: finding new broadband and voice providers able to adequately serve high-cost rural areas.

[1] Many investment firms also hold Windstream stock on behalf of individual investors or in income-focused mutual funds.

[2] Dividend payments are central to the mid-sized carrier's business model. A mid-sized carrier's stock is similar to a bond. Stock prices of these carriers, which are facing declining revenues, typically do not appreciate. Instead, mid-sized carriers reward equity investors by paying regular dividends. Without these dividends, investors would have little reason to hold onto their stock. If investors decide to sell their stock because of concerns about their investment, a mid-sized carrier's share price will decline, making it even more difficult for the carriers to obtain capital from the debt markets, which have been for all intents and purposes "closed" due to the extreme volatility in recent months.

[3] *See* 47 U.S.C. § 254(b) (articulating principles serving as the basis for "policies for the preservation and advancement of universal service," which include, but are not limited to, (i) consumers in "all regions of the Nation" should have access to telecommunications and information services at "reasonably comparable rates" and (ii) "quality services should be available at just, reasonable, and affordable rates").

[4] Most mid-sized carriers likely would decrease dividends or returns to shareholders only as a last resort, because this measure would be extremely harmful to their ability to maintain vital access to the capital markets.

II. The Reform Plan Grossly Underestimates the Negative Impact on Mid-sized Price Cap Carriers and the Customers They Serve.

Based on recent meetings with Commission staff, Windstream believes that the Commission has been grossly underestimating the negative impact that the reform proposal would have on mid-sized price cap carriers and the rural consumers they serve. Windstream estimates that the plan would cause it to lose hundreds of millions of dollars in revenues, with little or no ability to recover these substantial losses.

First, the Commission's proposal appears to rely on incorrect, unsubstantiated suggestions that eliminating intercarrier compensation will somehow enhance rural broadband deployment and a transition to all-IP voice.[5] Nothing could be further from the truth. Windstream's broadband and Voice over Internet Protocol ("VoIP") investment decisions are dictated solely by an assessment of whether projected new revenues and operational savings will outweigh the associated, gargantuan costs. With respect to broadband in particular, Windstream previously has estimated that it would cost $250 to $400 million to deploy broadband to reach the approximately 15 percent of its customers who currently do not have access to its broadband.[6] Windstream then would need to spend many millions more on ongoing broadband operating costs.[7] To deploy VoIP, Windstream expects it would need to spend hundreds of millions above and beyond capital and operating expenses necessary to support ubiquitous broadband.[8] It is unrealistic to think that a reduction in intercarrier compensation rates would change a mid-sized price cap carrier's decision about whether to

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[5] *See* Letter from Brian Benison, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92 and 96-45, WC Docket Nos. 05-337, 99-68, 07-135 (Aug. 5, 2008), Attachment at 2 (failing to identify any case where the alleged incentive of "carriers to cling to the traditional voice model" resulted in less broadband deployment); Letter from AT&T, CompTIA, CTIA, Global Crossing, The Information Technology Industry Council, National Association of Manufacturers, New Global Telecom, PointOne, Sprint Nextel Corp., The Telecommunications Industry Ass'n, T-Mobile, Verizon, and The VON Coalition to FCC Chairman Kevin J. Martin, WC Docket No. 04-36, CC Docket No. 01-92 (Aug. 6, 2008), at 3 (failing to identify any specific instance when reform to intercarrier compensation spurred "innovation and the deployment of . . . IP services as well as the broadband networks they ride over"); Letter from Ben Scott, Free Press, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45 and 01-92, WC Docket Nos. 05-337 and 06-122 (Oct. 13, 2008), at 5 (claiming that the current intercarrier compensation regime produces a "strong incentive for rural carriers to delay the full transition to the broadband world," but providing no examples of instances where this "strong incentive" led to actual delay).

[6] Comments of Windstream Communications, Inc., WC Docket No. 05-337, CC Docket No. 96-45, at 13-14 (Apr. 17, 2008) (this capital expense projection is based upon offering broadband at speeds ranging from 768 Kbps to 1.5 Mbps).

[7] *Id*. at 14-15 (such operating costs encompass, but are not limited to, transport fees that Windstream must pay to connect island exchanges to the Internet backbone; additional customer call center staffing required to support broadband products; creation and maintenance of a system that tracks the provision and capacity of each existing Digital Subscriber Line Access Multiplexer; grooming of cable pairs; and installation of jumpers to connect a phone line to broadband equipment).

[8] *See* Letter from Eric Einhorn, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45 and 01-92; WC Docket Nos. 99-68, 05-337, 06-122, 07-135, and 08-152 (Oct. 27, 2008) (establishing that transforming to an all-IP network is not economically viable for the foreseeable future and any such transition would require substantial, additional governmental support above and beyond what carriers currently receive from the Universal Service Fund).

incur these overwhelming costs – other than to make it *more difficult* for a carrier to dedicate scarce funds to further deployment of advanced services.

Second, the Commission's proposal, as we understand it, seems to adopt the unrealistic belief that the Commission can prevent harms to mid-sized price cap carriers by allowing the carriers to attain additional recovery after making a showing of confiscation. This "opportunity," as we understand it, is completely inadequate and likely ephemeral. Continued uncertainty would plague the mid-sized price cap carrier business model. By the time the Commission would make any decision about confiscation (even if a carrier could meet such a draconian standard), a mid-sized price cap carrier already would have suffered significant losses – both in terms of short-run decreases in intercarrier compensation revenues and flight of equity investment. This measure would provide too little relief, too late to prevent significant harm to mid-sized price cap carriers and the rural customers they serve.

Third, existing federal Universal Service Fund ("USF") support offers little consolation to mid-sized price cap carriers. A common misconception is that mid-sized price cap carriers, like Windstream, are funded largely by federal USF support. That simply is not the case. The outdated federal USF mechanisms provide a disproportionately large amount of support to small and mid-sized rate-of-return carriers, but do not provide adequate support to the mid-sized price cap carriers that serve high-cost rural areas of the Nation. Due to averaging of costs and inconsistencies between USF support calculations and rate regulations, the USF system fails to target support directly to the high cost areas where it is actually needed. Consequently, Windstream – with 27 percent of its exchanges comprised of 500 access lines or less – receives less than 1 percent of its total annual revenues from high-cost loop and model support, and less than 3 percent of its revenues from all federal high-cost support combined.

III. The Commission Should Adopt a Measured Approach to Intercarrier Compensation Reform.

Given the complexity of intercarrier compensation reform and the high stakes for rural consumers and carriers, Windstream requests that the Commission put the intercarrier compensation reform proposal out for public comment and formal consideration by the Federal-State Separations and Universal Service Joint Boards and the Federal-State Joint Conference on Advanced Telecommunications Services. Public release of the proposal will allow stakeholders to provide specific information about potential impacts, as well as offer modifications for consideration if appropriate. Moreover, this action would be consistent with the Commission's practice in other complex proceedings, such as when the Commission recently released its tentative conclusions and rules pertaining to the 700 MHz "D Block" auction.[9]

[9] *Service Rules for the 698-746, 747-762 and 777-792 MHz Bands, Implementing a Nationwide, Broadband, Interoperable Public Safety Network in the 700 MHz Band*, Third Further Notice of Proposed Rulemaking, FCC 08-230, WT Docket No. 06-150, PS Docket No. 06-229 (rel. Sept. 25, 2008) (seeking comment on its tentative conclusions and rules designed to create a nationwide interoperable public safety-private partnership through an auction of commercial spectrum ("D Block")).

If it is serious about enabling the shift to an all-IP network, the Commission must obtain a fact-based understanding of associated costs and benefits, and then craft public policies that will thoughtfully reach that goal. Merely ordering it "to be so" will not produce an all-IP network. Instead, the Commission should initiate a proceeding to gather facts so it can make informed decisions about any such transition.[10] In particular, it could seek input from the states and other experts, such as the Federal-State Joint Board on Universal Service and the Federal-State Joint Conference on Advanced Telecommunications Services.

The Commission's response to the D.C. Circuit's remand of *In re Core Communications* should not be used as justification for pushing out ill-considered comprehensive intercarrier compensation reforms. The stakes are too high and the details too important. The Commission can decide the issue of ISP-bound traffic on its own and separately seek comment on the comprehensive proposal before it, or with modifications as proposed below.

Alternatively, if the Commission believes it must take additional steps to address intercarrier compensation reform at this juncture, Windstream offers the following modifications to the proposal under consideration. These concurrent, interrelated modifications would ensure that intercarrier compensation reforms are more fair and balanced. As a result, Windstream likely would support intercarrier compensation reform if its recommended changes were made to the existing plan, as we understand it.

Windstream cautions, however, that the modifications outlined below, to be successful, must be made together and in the time sequence recommended. The intercarrier compensation plan, even with these revisions, would *not* make Windstream and other similarly situated carriers whole as compared to their position under the current intercarrier compensation regime (which Windstream recognizes is eroding). First, Windstream's interstate access rate reductions to its target CALLS rates resulting from its conversion to price cap regulation would not be recovered via the intercarrier compensation replacement mechanism.[11] Second, only 50 percent of the revenue reduction resulting from interstate, intrastate, and reciprocal compensation rate reductions from $.0065 to $.0055 would be recovered through the replacement mechanism. Third, the increased subscriber line charges would not be fully recovered, as rate increases are restrained by competition. And to the extent changes are made that will impose further intercarrier compensation revenue losses, these modifications could place mid-sized price cap carriers in further financial jeopardy.

Specifically Windstream proposes the following *concurrent, interrelated* modifications (which are outlined in further detail in the attached Appendix) to the intercarrier compensation plan currently before the Commission:

[10] Key questions to be asked are as follows: What steps are needed from a technological perspective to achieve the goal? How much will those changes cost? Would a transformation to all IP networks require regulation of the Internet backbone and/or transport arrangements to reach the backbone? What impact will such a transformation have on public safety? How would consumers benefit, and at what price?

[11] Windstream is required to reduce its interstate access rates to its CALLS targets, but under this proposal the transition to the lower rate would be accomplished in three years, rather than the longer transition provided under the CALLS rules.

- **First**, the Commission should transition each carrier's intrastate rates to its interstate rate levels by study area over several years.

- **Second**, the Commission must provide mid-sized price cap carriers, like Windstream, access to a recovery mechanism for recovery of lost intercarrier compensation revenues, offset in part by the subscriber line charge ("SLC") increases proposed in the plan (i.e., $1.50 for residential and single line business and $2.30 for multi-line business). A wide array of parties are on the record supporting the need for such a mechanism.[12] Funds from this recovery mechanism, which should apply after imputation of the rate benchmark and SLC increases, could be limited to operating and capital expenditures associated with support, maintenance, enhancements, and expansion of broadband offerings. This measure would replace the proposal to tie the future receipt of high-cost universal service support to a 100 percent broadband deployment commitment.

- **Third**, the Commission should issue a Further Notice of Proposed Rulemaking ("FNPRM") to seek comment on next steps and the framework for additional intercarrier compensation reform. The Commission should seek comment on, among many other items: whether to establish one unitary rate for all intercarrier compensation; unified rates by carrier, state, or track; the methodology for setting rates and establishing "additional cost" under Section 252(d)(2); and the proper role of state commissions, the Federal-State Separations and Universal Service Joint Boards, and the Federal-State Joint Conference on Advanced Telecommunications Services.

- **Fourth**, the Commission should preserve the status quo with respect to ISP-bound traffic and make it clear that VoIP traffic must continue to pay access and reciprocal compensation charges until the Commission issues a final order resulting from the FNPRM.

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[12] *See, e.g.,* Letter from Larry Cohen, Communications Workers of America, President, to Kevin Martin, Chairman, FCC, WC Docket Nos. 06-122 and 05-337, CC Docket Nos. 96-45 and 01-92 (Oct. 27, 2008), at 3 (urging the Commission to "establish a supplementary explicit universal service fund available to mid-size carriers for broadband build-out"); Letter from Brian Mefford, Connected Nation, Chairman and CEO, to Kevin Martin, Chairman, FCC, WC Docket Nos. 06-122 and 05-337, CC Docket Nos. 96-45 and 01-92 (Oct. 27, 2008), at 2 (urging the Commission to establish universal service recovery mechanisms that "should be available to all carriers of last resort, regardless of company size, structure or regulatory classification"); Letter from Walter McCormick, USTelecom, President, to Kevin Martin, Chairman, FCC, CC Docket No. 01-92 (Oct. 10, 2008), at 5, 7, 8 (declaring that "establishment of a credible and compensatory ARM is an essential element of comprehensive intercarrier compensation reform"); Letter from Curt Stamp, Independent Telephone and Telecommunications Alliance (ITTA), President, to Secretary Dortch, Secretary, FCC, CC Docket No 01-92 (Sept. 19, 2008), at 5 (recommending that mid-sized carriers be able to use an Alternative Recovery Mechanism); Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, et al. to Kevin Martin, Chairman, FCC, CC Docket No. 01-92 (filed July 24, 2006) (attaching the Missoula Plan) (proposing a plan that included a recovery mechanism, which could be used by mid-sized carriers) ("Missoula Plan Ex Parte Letter").

Please contact me if you have any questions regarding this proposal.

Respectfully submitted,

/s/ Eric N. Einhorn

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cc: Dan Gonzalez
Amy Bender
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Appendix

Minimum Necessary Steps to Modify Proposal

- Years 1-3 -- Reduce terminating interstate, intrastate, and reciprocal compensation access rates for price cap carriers, phased in equal increments annually, to each carrier's interstate CALLS target by study area pursuant to 47 C.F.R. § 61.3(qq) (i.e., $0.0095, $0.0065, or $0.0055).

- Years 4-5 -- Reduce terminating interstate, intrastate, and reciprocal compensation access rates for price cap carriers, phased in equal increments annually, to the lowest CALLS target pursuant to 47 C.F.R. § 61.3(qq)(1) (i.e., $0.0055) and unify any higher reciprocal compensation rates to that level.

- Establish an Intercarrier Compensation Replacement Fund -- Provides a revenue replacement opportunity for revenue losses due to mandated rate reductions.
  - Available to non-RBOC price cap carriers and Fairpoint.
  - For Years 1-3, equals cumulative revenue loss due to intrastate and reciprocal compensation rate reductions, assuming maximum SLC increases.
  - For Years 4-5, equals 50% of the total reduction (interstate, intrastate, and reciprocal compensation) to $0.0055 plus the cumulative total from Years 1-3.
  - Each year the amounts received from the Fund would be indexed by the carrier's previous year's reported percentage of subscriber line loss.
  - Could limit use of funds to support for operating and capital expenditures associated with support, maintenance, enhancements, and expansion of broadband offerings.
  - Offset recovery from the Fund with imputed SLC increases.
  - Establish a rate benchmark so as not to overburden consumers in states that have already rate rebalanced.
  - This measure would replace the proposal to tie the future receipt of high-cost universal service support to a 100 percent broadband deployment commitment.

- Clarify treatment of VoIP traffic during transition, as follows:
  - VoIP to PSTN calls: Local (by telephone number) calls pay reciprocal compensation. Appropriate interstate and intrastate rates due on non-local calls (by telephone number) until interstate and intrastate rates are equal.
  - PSTN to VoIP calls: Local calls pay reciprocal compensation. Originating and terminating access due on non-local calls. Terminating access rate declines as provided in the transition plan. Originating access remains until end of transition.

- Issue a FNPRM seeking comment on steps for additional comprehensive intercarrier compensation reform during Years 5-10. The Commission should seek comment on, among many other items, whether to establish one unitary rate for all intercarrier compensation; unified rates by carrier, state, or track; the methodology for setting rates and establishing "additional cost" under Section 252(d)(2); and the proper role of state

Commissions; the Federal-State Separations and Universal Service Joint Boards; and the Federal-State Joint Conference on Advanced Telecommunications Services.

- Refer to the Federal-State Separations and Universal Service Joint Boards relevant issues, such as: whether to set a rate benchmark to constrain SLC increases in high rate states; whether a mechanism is needed to replace access or reciprocal compensation revenues during the next stage; and the impact of any changes or transitions on the separations process.

- Preserve the status quo with respect to ISP-bound traffic, pending completion of the FNPRM referenced above.