DOCKET FILE COPY ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

FILED/ACCEPTED

NOV - 5 2009

Federal Communications Commission
Office of the Secretary

Reducing Universal Service Support	)	RM- ________
In Geographic Areas That Are	)	
Experiencing Unsupported	)	RM-11584
Facilities-Based Competition	)	

PETITION FOR RULEMAKING

Neal M. Goldberg
Steven F. Morris
National Cable &
Telecommunications Association
25 Massachusetts Avenue, N.W. – Suite 100
Washington, D.C. 20001-1431

November 5, 2009

A-9-9λ

EXECUTIVE SUMMARY

In this petition for rulemaking, the National Cable & Telecommunications Association (NCTA) proposes that the Commission establish procedures to reduce the amount of universal service support provided to carriers in those areas of the country where there is extensive, unsubsidized facilities-based voice competition and where government subsidies no longer are needed to ensure that service will be made available to consumers. The Commission's high-cost support mechanisms are premised on the assumption that a particular location would not have affordable service available but for the support provided by the program. But in markets with extensive facilities-based competition, that assumption no longer holds true. The presence of one or more unsubsidized wireline competitors generally should be sufficient to ensure that consumers will have access to reasonably priced service even if government subsidies are reduced or eliminated.

Under NCTA's proposal, the Commission would establish a two-step process by which any party may request that the Commission reassess the level of support provided to a particular geographic area. In the first step, the burden would be on the petitioner to demonstrate that the area meets one of two competition-based triggers. Specifically, the petitioner would be required to demonstrate either (1) that unsubsidized wireline competitors offer service to more than 75 percent of the customers in an area without support or (2) that the state has found sufficient competition to substantially deregulate the retail rates charged by an incumbent local exchange carrier (ILEC).

If one or both of those triggers is satisfied, the Commission would initiate the second step of the proceeding. In that step, the burden would be on a USF recipient to demonstrate the minimum amount of support necessary to ensure that non-competitive portions of the area will continue to be served. In this stage of the process, the Commission would identify any ILEC costs, including costs attributable to any provider of last resort obligations imposed under state law, that cannot be recovered through any of the services (regulated or unregulated) provided over the network in the portion of the study area without competition.

NCTA's proposal is a modest first step on the road to USF reform. In particular, it recognizes that the competitive situation in each market is different and that a one-size-fits-all solution may not be feasible. Rather, NCTA is proposing a fact-based approach that appropriately reflects marketplace realities. The initial screen we propose is intended to ensure that only areas with extensive unsubsidized wireline competition will be subject to review, while the second step of the proposed process will provide USF recipients a full opportunity to demonstrate any continued need for high-cost support.

As explained in the attached report by Dr. Jeffrey Eisenach, over $1 billion in high-cost support goes to rural LECs and competitive eligible telecommunications carriers (CETCs) in areas experiencing extensive facilities-based competition. Non-rural LECs and CETCs in states that have deregulated retail rates receive support totaling almost another $1 billion. With the USF contribution factor continuing to escalate at a dramatic pace, reducing these funding levels in areas where support no longer is needed is critically important. Taking steps to reduce the contribution factor and control the size of the existing high-cost fund will enable the Commission to begin considering whether, and how, it may be able to use USF funding to provide additional targeted subsidies that can more efficiently help to meet the Nation's broadband policy goals.

TABLE OF CONTENTS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

Reducing Universal Service Support In Geographic Areas That Are Experiencing Unsupported Facilities-Based Competition	))))	RM-_______

PETITION FOR RULEMAKING

Pursuant to 47 C.F.R. § 1.401, the National Cable & Telecommunications Association (NCTA) submits this petition seeking new rules to expedite the transition of the federal high-cost fund away from a monopoly-era support program and toward a more modern, neutral, and pragmatic mechanism.[1] In particular, we propose that the Commission establish procedures to reduce the amount of high-cost support provided to carriers in those areas of the country where unsupported facilities-based voice competition is flourishing and where government subsidies no longer are needed to ensure that service will be made available to consumers.[2] As explained below, the continuing need for almost $2 billion in funding should be reassessed by the Commission pursuant to the procedures proposed in this petition. With the contribution factor continuing to escalate at a rapid pace,[3] reducing wasteful spending in areas that are experiencing

[1] Attachment A to this petition includes a set of proposed rules as required under 47 C.F.R. § 1.401(c).

[2] NCTA's proposal would not affect support received under the Lifeline or LinkUp programs. The proposal also would not affect high cost support to tribal lands. *See infra* n.32. As a result, NCTA's proposal ensures continued support to those most in need of universal service support to ensure that basic telecommunications service needs are met.

[3] *See* Jeffrey A. Eisenach, *Universal Service Subsidies To Areas Served By Cable Telephony* at 29 (November 2009) (attached as Attachment B) (Report or Eisenach Report) (documenting contribution factor changes from 2000 – 2009); *see also* Universal Service Administrative Company, Federal Universal Service Support Mechanisms Fund Size Projections for First Quarter 2010, Appendix M02, available at http://www.usac.org/about/governance/fcc-filings/2010/Q1/M02%20-%20Fund%20Size%20Projection%20for%201Q2010.xls (projecting over $2 billion in USF funding needed for the 1st quarter of 2010). The precise contribution factor for next quarter will depend on the revenue base that

robust facilities-based voice competition from wireline providers that do not receive funding is critically important. Reducing the contribution factor and controlling the size of the existing high-cost program also creates an opportunity for the Commission to consider whether, and how, it might establish targeted programs that promote broadband deployment and adoption.

INTRODUCTION

NCTA is the principal trade association for the U.S. cable industry, representing cable operators serving more than 90 percent of the nation's cable television households and more than 200 cable program networks. The cable industry is the nation's largest provider of high-speed Internet access ("broadband") after investing over $145 billion since 1996 to build two-way interactive networks with fiber optic technology.

When Congress directed the FCC to create the USF program in 1996,[4] incumbent local exchange carriers (ILECs) possessed a monopoly in the local exchange market, interexchange carriers were the only companies providing long distance service, wireless was a nascent service generally considered to be a luxury, and broadband Internet access was virtually nonexistent. Thirteen years later, "the communications landscape has undergone many fundamental changes that were scarcely anticipated when the 1996 Act was adopted."[5] With respect to telephony, cable operators today provide voice service to over 20 million customers, often offering it in

---

will be assessed for purposes of collecting this $2 billion, but some analysts believe it will exceed 14 percent, which would be the highest level ever. *See* Stifel Nicolaus, *Industry Assessments Expected to Jump, Up Pressure for USF/Intercarrier Reform* (Nov. 3, 2009).

4 47 U.S.C. § 254(a)(2).

5 *High-Cost Universal Service Support*, WC Docket No. 05-337, *et al*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd 6475, 6493, ¶ 39 (2008) (*Comprehensive Reform FNPRM*).

rural areas throughout the country.[6] Already, cable's entry into the voice market has produced tens of billions of dollars in consumer benefit and promises even greater benefits in the future.[7]

No less striking has been the rapid expansion of cable broadband services. Cable operators have built, with private capital, broadband infrastructure that today is available to 92 percent of U.S. households. In 1996, cable operators counted less than a million broadband subscribers, but today cable provides broadband service to an estimated 40 million subscribers. In most areas, cable operators are providing these services in competition with services offered by an ILEC, as well as multiple wireless providers and, in some cases, satellite providers.

Notwithstanding these fundamental marketplace changes, however, the USF program operates as if nothing has changed since 1996. Even as millions of Americans take service from facilities-based wireline competitors, and millions more decide they no longer need wireline voice services at all,[8] the Commission continues to provide billions of dollars of support for wireline voice services provided by ILECs. And because of structural flaws in the USF program, new entry by facilities-based competitors often has the perverse effect of *increasing* the subsidy a geographic area receives.[9] As a result, the total size of the federal USF program, and the resulting burden on consumers, continues to escalate at a staggering rate.[10]

---

6 Many cable operators offer these services at national rates that are the same in rural areas as they are in urban areas. *See* Comments of the National Cable & Telecommunications Association, WC Docket No. 05-337 (filed May 8, 2009) (NCTA NOI Comments) at 8-9. Cable voice services generally are available on a stand-alone basis or as part of a bundle with high-speed Internet service and/or multichannel video service.

7 Michael Pelcovits and Daniel Haar, *Consumer Benefits from Cable-Telco Competition* (updated Nov. 2007), available at http://www.micradc.com/news/publications/pdfs/Updated_MiCRA_Report_FINAL.pdf.

8 As reported by the Centers for Disease Control, over 20 percent of American households now rely exclusively on wireless service for their telecommunications needs and another 15 percent purchase wireline service but receive all or virtually all of their calls on a wireless phone. Blumberg and Luke, *Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, July-December 2008* (rel. May 6, 2009), available at http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless200905.pdf.

9 The Commission has addressed this issue on a temporary basis by adopting an interim cap on CETC support. *High-Cost Universal Service Support*, WC Docket No. 05-337, Order, 23 FCC Rcd 8834 (2008) (*Interim Cap*

Compounding these concerns is the near universal recognition that some level of government subsidy will be needed to achieve the congressional goal of providing all Americans with access to broadband capability. As NCTA has explained previously, with contribution rates now exceeding 12 percent (and expected to climb even higher), simply extending the existing USF program to cover broadband services and facilities is not a viable option for the Commission.[11] Rather, any effort to use the USF program to subsidize broadband must be preceded by actions to control the size of the existing mechanisms and to more carefully target any future subsidy.

In this petition, NCTA offers a fresh approach to calculating the level of high-cost support in study areas that are experiencing facilities-based wireline voice competition. The basic premise underlying this proposal is that the amount of high-cost support should be substantially reduced, if not eliminated completely, in geographic areas where deregulatory actions by the state or other marketplace evidence suggests that facilities-based competition from unsubsidized entrants is extensive. As Commissioner McDowell recently explained, "a Universal Service system should not reward companies for losing customers to competitors."[12]

The Commission's high-cost mechanisms are based on the assumption that a particular location would not have affordable voice service available but for the support provided by the

---

Order). To the extent it would reduce support to all providers in areas experiencing unsubsidized competition, NCTA's proposal represents a more comprehensive approach to addressing this issue.

[10] *See* n.3 supra; *see also Comprehensive Reform FNPRM* at ¶ 39; Presentation of the Omnibus Broadband Initiative team to the Federal Communications Commission, Slide 48 (Sept. 29, 2009), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-293742A1.pdf.

[11] NCTA NOI Comments at 5 ("it would be irresponsible for the Commission to focus on broadband without first fixing the current USF mechanism to avoid unnecessary and wasteful payments").

[12] *High-Cost Universal Service Support*, WC Docket No. 05-337, Order and Notice of Proposed Rulemaking, FCC 09-89, Concurring Statement of Commissioner Robert M. McDowell (rel. Oct. 9, 2009).

program.[13] But in markets with extensive facilities-based competition, that assumption no longer holds true. The presence of one or more unsubsidized wireline competitors should be sufficient to ensure that consumers will have access to reasonably priced service even if government subsidies are reduced or eliminated.

Under NCTA's proposal, the Commission would establish a two-step process by which any party may request that the Commission reassess the level of support distributed to providers to a particular study area. In the first step, the burden would be on the petitioner to demonstrate that the area meets one of two competition-based triggers. Specifically, the petitioner would be required to demonstrate either (1) that wireline competitors offer service to more than 75 percent of the customers in an area without support or (2) that the state has found sufficient competition to substantially deregulate an ILEC's retail rates. If one or both of those triggers is satisfied, the Commission would initiate the second step of the proceeding. In that step, the burden would be on a USF recipient to demonstrate the minimum amount of support necessary to ensure that non-competitive portions of the area will continue to be served. As explained below, this process would identify those ILEC costs that cannot be recovered through any of the services (regulated and unregulated)[14] provided in the non-competitive portion of the study area, including costs associated with any applicable provider of last resort (POLR) obligations.

As explained in the attached report by Dr. Jeffrey Eisenach, over $1 billion in high-cost support goes to rural LECs and CETCs in areas experiencing extensive facilities-based

---

[13] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration and Further Notice of Proposed Rulemaking, 16 FCC Rcd 11244, 11251, ¶ 13 (2001).

[14] Michael D. Pelcovits, *Debunking the Make-Whole Myth: A Common Sense Approach to Reducing Irrational Telecommunications Subsidies, White Paper #3* (Nov. 17, 2008) (Pelcovits Subsidy Paper) at 26 ("Simply put, there is no reason to subsidize an ILEC to serve an area where revenue from voice, data and video service is sufficient to offset the costs of providing service."), available at http://www.micradc.com/news/publications/pdfs/MP/White_Paper_3_FINAL.pdf.

competition.[15] Non-rural LECs and CETCs in states that have deregulated retail rates receive support totaling almost another $1 billion. Reducing these funding levels in areas where support no longer is needed is critical to bringing the USF contribution factor back to more reasonable levels and is an essential prerequisite to considering whether, and how, USF funding could be used to provide additional targeted subsidies that can more efficiently help to meet the Nation's broadband policy goals.[16]

I. THE CURRENT USF PROGRAM HAS NOT BEEN UPDATED TO REFLECT IMPROVED TECHNOLOGY AND INCREASED FACILITIES-BASED WIRELINE COMPETITION

A. Competitive Developments Have Reduced The Need For Support In Many Areas Of The Country

Since the USF program was established, the communications marketplace has witnessed significant improvements in technology, particularly the transition to IP-based equipment and services. These advancements have made it possible for some cable operators and other facilities-based competitors to enter areas without support where competitive entry may have been economically prohibitive in the past and to offer a wider array of services.

While cable voice services initially were introduced in urban areas, today cable operators provide competitive voice service in hundreds of rural areas across the country. The Eisenach Report documents the extensive scope of cable voice services in areas served by rural ILECs. The report finds that cable voice service is available to approximately 80 percent of U.S.

[15] Report at 2.

[16] Because this process will take time, NCTA continues to support the adoption of a cap on the total size of the high-cost program. NCTA NOI Comments at 5 ("[T]he first step in any USF reform effort should be for the Commission to cap the total size of the high-cost fund."). Capping the fund is the only way to guard against continued escalation in the amount consumers are paying for this program while the Commission considers how to transition to a more rational approach.

households.[17] In rural LEC study areas, the report finds that over 6.6 million households, or 43 percent, have access to cable voice services.[18]

The Eisenach Report's documentation of the extent of cable voice service in rural areas is echoed by numerous ILECs, who routinely point to the existence of such competition as the basis for their own regulatory relief. For example, in a filing last year, Embarq (now part of CenturyLink) stated that it faced competition from cable operators for 70 percent of the households in its largely rural service area.[19] Other ILECs also have acknowledged that they face extensive competition in rural areas.[20]

The Eisenach Report also confirms that cable operators are not merely "cherry picking" low-cost customers and leaving rural LECs to serve the highest-cost customers. In many areas, cable operators offer service to more than 75 percent of households, and in some cases they offer service to 90-100 percent of households in the ILEC's study area.[21] Moreover, as the Eisenach Report demonstrates, there are numerous areas where the portion of a study area that is not

---

[17] As discussed in the report, estimates vary on the extent of cable voice coverage. Kagan estimates the availability figure at 84 percent, while Warren estimates it at 74 percent. Report at 15. The Commission first required VoIP providers to report subscriber data in March 2009. When that data is published by the Commission, it should provide an accurate estimate of the availability of cable VoIP services, on a census tract basis, for year-end 2008.

[18] Report at 16. That figure would be even higher were it not for the continuing efforts of some rural LECs to refuse to interconnect with cable operators and the wholesale providers they work with. For example, Comcast requested interconnection with Telephone and Data Systems, Inc. (TDS) affiliates in six different states between April and July of 2008. Eighteen months later, Comcast is just completing arbitrations where the sole issue raised by TDS was whether Comcast was entitled to interconnection. During 2008, TDS and its affiliates received over $231 million in federal USF support. Time Warner Cable has encountered similar resistance to its entry by a number of rural ILECs. *See* Letter from Matthew A. Brill, Counsel for Time Warner Cable, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 09-51 (filed Oct. 21, 2009).

[19] Petition for Waiver of Embarq Local Operating Companies, WC Docket No. 08-160 (filed Aug. 1, 2008) at 14 ("Moreover, the potential competition that VoIP actually represents is even greater than it appears, given that cable-based telephony, which nearly always also provides a broadband connection into households, is available to more than 70 percent of customers in Embarq's service territories-a percentage that continues to grow.").

[20] *See, e.g.*, Centurytel Petition for Conversion to Price Cap Regulation and For Limited Waiver Relief, WC Docket No. 08-191 (filed Aug. 29, 2008) at 10; Windstream Petition for Conversion to Price Cap Regulation and For Limited Waiver Relief, WC Docket No. 07-171 (filed Aug. 6, 2007).

[21] Report at 20.

served by cable appears to be no more expensive to serve than the area that is covered, which suggests that support may be unnecessary even in the noncompetitive portion of the study area.[22] As the Commission previously has recognized, cable franchise areas often do not have the same boundaries as ILEC study areas.[23] The Eisenach Report demonstrates that in many cases the portion of a study area not served by a cable operator has the same density and topography as the area that is served. Because these factors, particularly density, are strongly correlated with the cost of building facilities, high-cost support may be unnecessary in these circumstances.[24]

Significantly, cable operators generally have entered these areas without any federal high cost support. The extensive availability of unsubsidized cable voice services in rural America makes clear that the Commission can dramatically reduce the amount of support that is provided to many areas of the country without any reduction in the quality of service available to consumers living in those areas.[25] The Commission should seize the opportunity to establish a process that makes such reductions a reality.

B. Flaws In The Current USF System Result In Increased Support For Areas That Should Receive Less Support

As the Commission recognized last year, the current support mechanisms do not reflect the significant marketplace changes described in the previous section.[26] While the rural and non-

---

[22] Report at 21-24.

[23] *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, Notice of Proposed Rulemaking, 23 FCC Rcd 1495, 1503, ¶ 19 (2008).

[24] For example, in proceedings in Maine, Time Warner Cable demonstrated that its proposed service area had cost characteristics similar to the areas served by the rural ILECs that were attempting to block its entry. *See* Direct Testimony of Dr. August H. Ankum on Behalf of CRC Communications of Maine at 59-72, Maine PUC Docket Nos. 2009-40, 41, 42, 43, 44 (filed Oct. 9, 2009).

[25] Press Release, *J.D. Power and Associates Reports: Overall Consumer Satisfaction with Residential Telephone Services Increases Considerably* (Sept. 16, 2009) ("The 2009 study marks the third consecutive year that traditional cable television providers have achieved the highest rankings in all regions included in the study."), available at http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2009199.

[26] *Comprehensive Reform FNPRM* at ¶ 39 ("The communications landscape has undergone many fundamental changes that were scarcely anticipated when the 1996 Act was adopted. . . . these developments have challenged

rural high-cost programs have enabled some companies to build networks to serve areas that otherwise might have been uneconomic to serve, they provide far more support, for a far longer time, than is necessary to ensure the availability of service in some areas. This is especially true as many ILECs have accumulated very large depreciation reserves on their embedded plant, thereby reducing substantially the size of their regulated rate base.[27]

One reason for this situation is that neither program contains a mechanism for reassessing whether the need for support to a particular location or carrier has changed due to changing conditions in the marketplace. The Commission's initial decision that an area is "high cost" – and therefore needs USF support – implicitly assumes that these high costs preclude entry by unsubsidized competitors. But there is no mechanism for revisiting whether a particular area should receive high-cost support, even where evidence demonstrates that facilities-based competitors have entered the market and are offering affordable voice service without subsidies. As a result, the Commission is providing hundreds of millions of dollars every year to LECs and CETCs that are serving areas that no longer need to be subsidized.

Not only does the current USF program not reassess whether support is still needed in a particular area, or whether it is needed at current levels, but the rural LEC program includes features that lead to ever-increasing growth in the amount of support once competitive entry occurs. Under the program for rural LECs, as competitors enter a market and win customers from the incumbent, the amount of per-line support provided to a rural LEC increases because of Commission rules that average all fixed costs across the number of lines served.[28] As the Joint

---

the outdated regulatory assumptions underlying our universal service and intercarrier compensation regimes, forcing us to reassess our existing approaches.").

[27] Pelcovits Subsidy Paper at 21-25.

[28] *See In the Matter of Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange*

Board has explained, "most of the existing mechanisms were introduced before local exchange competition became a reality, and may not appropriately adjust support to reflect line losses due to competition."[29] Before the Commission adopted the interim cap on CETC support, the increased amount of per-line support served to attract additional CETC applications, which in turn resulted in further increases in per-line support. In short, were it not for the interim cap, the rules operate so that a competitor's market-based decision to serve a particular area without receiving support not only fails to reduce the amount of the subsidy provided to the incumbent, but it in fact creates an incentive for other providers to seek support.[30]

Providing increased government support to areas benefiting from private investment and competitive entry is exactly the opposite of what should occur under a well-structured program. When circumstances have changed to the point where competitive entry becomes economic without any subsidy, the appropriate question should be whether, and by how much, to *decrease* support. But the current regime never asks that question and has no procedure by which it can be raised. In the next section, NCTA offers a proposed solution to these problems.

Carriers, Fourteenth Report And Order, Twenty-Second Order On Reconsideration, and Further Notice Of Proposed Rulemaking In CC Docket No. 96-45, and Report And Order In CC Docket No. 00-256, 16 FCC Rcd 11244, 11294-95, ¶ 125 (*MAG Order*) ("If the incumbent's lines decreased while its fixed costs remained roughly the same, its per-line costs would increase. Consequently, the incumbent would be entitled to higher support per line.").

29 *High-Cost Universal Service Support*, WC Docket No. 05-337, Recommended Decision, 22 FCC Rcd 20477, 20483, ¶ 22 (2007).

30 For non-rural LECs, the Commission uses a forward-looking cost model to determine which "high cost" areas receive support. *See High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Inquiry, 24 FCC Rcd 4281, 4283, ¶ 4 (rel. Apr. 8, 2009) (*Qwest Remand NOI*). The amount of support a particular study area receives is not affected by competitive entry the way it is for rural LECs. But as NCTA has explained previously, the non-rural fund suffers from many other problems, such as a lack of any reliable method of ascertaining a non-rural LEC's costs. NCTA NOI Comments at 10-11.

II. THE COMMISSION SHOULD CONDUCT A PROCEEDING TO REASSESS SUPPORT LEVELS IF ONE OR MORE COMPETITION-BASED TRIGGERS IS SATISFIED

The presence of an unsubsidized facilities-based provider in a study area where one or more providers is receiving support is evidence that the high cost program is not working as it should, or rather, that it is working harder than is necessary given marketplace developments. In the past, the Commission has focused on ways to potentially reduce the support that is provided to CETCs in this type of scenario.[31] The decision to cap support to CETCs was at least a recognition of the need to control the size of the high-cost program, but it fails to address the full scope of the problem with the current regime. Where additional unsubsidized providers have invested in networks, the fundamental reason for providing USF support may no longer exist, and the Commission must look at whether it is possible to reduce the total amount of government support that is made available to the minimum level necessary to ensure that all customers continue to have service.

One challenge facing the Commission in reforming the current high-cost program is that competitive conditions vary from area to area and a one-size-fits-all approach may not be feasible. To address the problems identified above in a manner that reflects these marketplace realities, NCTA proposes that the Commission develop a fact-based procedure to reassess the amount of support made available to a particular location where there is evidence the market is working to make service available without subsidies.[32]

---

[31] *Interim Cap Order*, 23 FCC Rcd at 8834, ¶ 1.

[32] NCTA proposes that tribal areas, including Alaska, be excluded from the scope of this petition. Tribal areas face special economic challenges in bringing even basic services to consumers and support to those locations should be left undisturbed. The Commission's universal service policies have long recognized the special telecommunications challenges for tribal lands, which persistently report the lowest telephone subscribership in the country. *See, e.g., High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 24 FCC Rcd 3369, 3372, ¶ 9 (2009); *Interim Cap Order*, 23 FCC Rcd at 8848, ¶ 32 (2008); *Federal-State Joint Board on Universal Service; Promoting Deployment and*

Specifically, NCTA proposes a two-step process. In the first step, any party may file a petition seeking a review of the amount of support that is distributed to a particular study area. The burden would be on the petitioner to demonstrate that one of the two competition-based triggers described below has been satisfied in that area. This initial screen is designed to focus the efforts of the Commission and other parties on the subset of study areas where competition is most advanced, while leaving support unaffected in areas that are less competitive. Where a petitioner makes the required showing, the Commission would proceed to the second step. In that step, the Commission would determine the minimum amount of support needed to ensure the continued provision of service to all customers, including the cost associated with complying with applicable provider of last resort obligations in that state. In the second step, the burden would be on a USF recipient to demonstrate the continued need for support.

A. Step 1 – Does The Geographic Area Satisfy One Of Two Triggers?

Trigger #1 – Extensive Coverage By Unsubsidized Wireline Competitors.

NCTA proposes that the Commission initiate a proceeding to reduce high cost support (Step 2 below) in any study area where it can be demonstrated that competitive wireline voice service from a provider that does not receive high-cost support is available to at least 75 percent of the households in the study area. Where a significant majority of customers in a study area have competitive alternatives available from an unsubsidized provider, the Commission can be confident that reducing support to any subsidized providers will not jeopardize the availability of reasonably priced service in that area. Establishing a threshold at the 75 percent level makes it

Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas, CC Docket No. 96-45, Twelfth Report and Order, Memorandum Report and Order, and Further Notice of Proposed Rulemaking, 15 FCC Rcd 12208, 12211-12, ¶ 2 (2000) (concluding that "existing universal service support mechanisms are not adequate to sustain telephone subscribership on tribal lands.").

less likely that the Commission will be presented with proposals to reduce support in situations where a competitor only serves the low-cost portion of the study area.

Even where a petitioner cannot demonstrate that an area meets the 75 percent threshold, the Commission also should advance to Step 2 upon a showing that competitive wireline service from a provider that does not receive high-cost support is available to at least 50 percent of the households in the study area and that the portion of the study area with no wireline competition has cost characteristics that are comparable to the covered portion (*e.g.*, similar terrain and population density). As explained in the Eisenach Report, a study area may have relatively uniform cost characteristics, but a cable operator may serve only a portion of that study area because its franchise boundaries do not match the boundaries of the ILEC study area.[33] The Commission should reassess the level of support provided in those cases just as it should in cases where the 75 percent threshold is satisfied.

The competition-based trigger described above is an extremely conservative first step toward meaningful USF reform. As shown in the Eisenach Report, at present the majority of rural LEC study areas would not currently qualify under this trigger and therefore would not experience any change in the level of high cost support they receive. And providers in those areas that do qualify would not automatically lose support, but instead would have the opportunity to demonstrate the level of support that is needed to ensure continued provision of service to all consumers in the area.

Moreover, for purposes of this element of NCTA's proposal, only facilities-based wireline providers that do not receive support would be considered in determining whether the coverage trigger is satisfied. Although there is growing evidence that consumers consider

---

[33] Report at 17-18.

wireless voice service to be a complete substitute for wireline voice service, the Commission has yet to make such a finding and we recognize that including wireless providers in this analysis would add complexity. Similarly, although millions of households that do not have access to cable voice services may have the ability to use over-the-top VoIP services through cable broadband connections, the availability of such services also would not be counted for purposes of the coverage trigger. While both wireless and over-the-top providers certainly offer competition to facilities-based wireline providers, and new options for consumers, the Commission might want to consider starting with a more conservative approach that focuses on the easiest cases for reducing support.

Trigger #2 – ILEC Deregulation.

As explained above, the premise underlying the high cost fund is that, absent financial support from the federal government, market forces would not be sufficient to ensure that services are provided in the supported location at reasonable rates. By contrast, a decision by a state commission or state legislature that an ILEC's rates no longer need to be regulated is premised on the opposite conclusion, *i.e.*, that market forces should be sufficient to ensure that service in the deregulated area will be provided at reasonable rates. Where a state has made such a finding and deregulated local exchange service provided by the ILEC (whether provided on stand-alone basis or as part of a bundled offering), the fundamental premise for providing a government subsidy is thrown into doubt and a process for reducing, if not eliminating completely, high cost support for the ILEC should be initiated.[34]

---

[34] NCTA's proposal is focused on situations where unsubsidized wireline competition exists in a particular study area. Areas with two or more subsidized wireline competitors present different, more complicated, issues. Given that such situations are relatively unusual, we have not included a specific proposal for how they should be addressed.

The record in the Commission's existing docket on USF reform already contains evidence of this phenomenon. Mississippi, for example, receives more non-rural support than any other state. As explained by the Mississippi Cable Telecommunications Association, "Mississippi is the 'poster child' for how far the USF system, particularly those portions supporting non-rural LECs, has strayed from whatever rational bounds may have existed."[35] The local rates of the largest ILEC in Mississippi (AT&T) have been substantially deregulated since 2006.[36] The decision by the Mississippi legislature to deregulate rates reflects its conclusion that market forces are more than adequate to ensure that service will be made available at reasonable rates. Given that finding by the state legislature, the Commission should revisit whether it is necessary to continue providing hundreds of millions of dollars to non-rural LECs in Mississippi.[37]

Many other states have been deregulating local rates, including some of the largest recipients of non-rural support. Some states have completely stopped regulating rates. The Iowa Utilities Board, for example, stopped regulating local rates in 2008.[38] The Indiana Utilities Regulatory Commission lost its ratemaking authority earlier this year.[39] The Alabama Public Service Commission will lose authority to regulate basic rates in 2011.[40]

---

[35] Comments of the Mississippi Cable Telecommunications Association, WC Docket No. 05-337 (filed June 9, 2009) at 3 (MCTA NOI Comments).

[36] *Id.* at 2-3, citing Miss. Code Ann. § 77-3-35(4)(a). ("[T]he legislature has determined that, in the provision of all services other than switched access service and single-line flat rate voice communications service, competition or other market forces adequately protect the public interest.")

[37] MCTA NOI Comments at 3-4.

[38] Iowa Code § 476.1D ("Effective July 1, 2008, the retail rate jurisdiction of the board shall not be applicable to single line flat-rated residential and business service rates.").

[39] Ind. Code 8-1-2.6-13 ("After June 30, 2009, the commission does not have jurisdiction over any of the following with respect to a communications service provider: (1) Rates and charges for communications service...").

[40] Ala. Code 1975 § 37-2A-8(b)(1)(c) ("Beginning January 1, 2011, the commission shall not have any jurisdiction, right, power, authority, or duty to regulate, supervise, control, oversee, or monitor, directly or indirectly, the costs, rates, charges, terms, or conditions for basic telephone service.").

Other states have taken a slightly different approach, deregulating rates if an incumbent LEC can show that a threshold level of competition exists. Virginia, for example, will deregulate if an ILEC demonstrates that 75 percent of households can receive service from a competitive provider,[41] essentially the test NCTA proposes in Trigger #1 above. Along the same lines, Texas deregulates rates in any area with three providers, including wireless carriers.[42]

For purposes of this proposal, the deregulation trigger may be satisfied even in states that continue to require a stand-alone local service at regulated rates. Where an ILEC is authorized to provide local service as part of a deregulated bundle, all components of the bundle essentially are deregulated because there is no regulation of the bundled price. Given the popularity of bundled offerings, a continuing obligation to provide stand-alone local service at a regulated rate has little practical effect on the rates consumers pay for service. For the same reason, providing a subsidy to a service that is provided as part of a bundle has the effect of subsidizing the provision of each service in the bundle. In areas where unsubsidized providers are offering similar bundles, such an approach is an irresponsible use of government funding.[43]

While the details of deregulation vary, in all of these cases the decision by a state to deregulate retail rates severs the connection between the receipt of universal service funding and the reasonableness of a provider's rates.[44] At that point, with multiple providers offering service to consumers at unregulated rates, continuing to provide government support is wasteful and

---

[41] Va. Code § 56-235.5 I.

[42] Tex Util. Cod. Ann. 26.134, 26.211, and 26.230.

[43] While a continuing obligation to offer stand-alone local exchange service at a regulated rate should not preclude a finding that Trigger 2 is satisfied, it should be considered in assessing the revenue potential of a particular area as part of the Step 2 process for determining how much support a carrier needs.

[44] Because the details of deregulation vary in each state, there may be study areas that satisfy Trigger 2 but not Trigger 1, *e.g.*, if a state considers wireless competition, which is not considered in Trigger 1, as a basis for deregulating ILEC rates. As long as one of the two triggers is satisfied, the Commission can be confident that a study area is sufficiently competitive that consideration of USF reductions in Step is warranted.

unnecessary and simply serves to skew the marketplace by providing funding to an incumbent carrier but not to its competitors.

B. Step 2 – What Is The Minimum Support Needed To Serve A Particular Area?

If the Commission finds a petition demonstrates that one or both triggers are satisfied, it should proceed to a review of the support situation in that study area. Such a proceeding would give the agency an opportunity to consider all of the relevant facts as to how competition has developed in that area, the prices that competitors are charging for regulated and unregulated services, and the effect on all providers, and on consumers, if high-cost support were reduced or eliminated. The goal of the proceeding should be to identify the limited subset of ILEC costs that (1) would not be incurred but for the provision of service to customers that do not have a competitive option and (2) cannot be recovered through rates for the services (regulated and unregulated) provided over the network in the portion of the study area with no competition.

This is a very different inquiry than takes place under the current system. For rural LECs, the current rules consider virtually all of a LEC's network costs and divide that amount by the number of lines served. As a rural LEC loses access lines, its average cost per line increases and it receives more support for each line.[45] As noted above, for non-rural LECs, the Commission uses a forward-looking cost model to determine which "high cost" areas receive support, and providers receive support for costs above a certain threshold.[46]

In contrast to either of these current approaches, the new approach proposed by NCTA starts from the premise that the costs of operating in the portion of the study area served by an unsupported provider should not be subsidized at all (*i.e.*, they should be recovered from

[45] *MAG Order*, 16 FCC Rcd at 11294-95, ¶ 125.

[46] *Qwest Remand NOI*, 24 FCC Rcd at 4283, ¶ 4.

customers of the services provided over the network) and that the subsidy, if any, should be limited to those additional ILEC costs that are solely attributable to bringing service to the non-competitive portion of the study area and that cannot be recovered through these services. The burden should be on the ILEC to demonstrate that the total cost of serving areas where it is the sole provider is greater than the total revenues that it potentially can generate from services sold to customers in that area.[47] In cases where the ILEC's rates have been deregulated, any claim that costs cannot be recovered should be subject to particular scrutiny.

Focusing on identifying costs that cannot be recovered from services provided in the non-competitive portion of the study area should enable the Commission to eliminate completely certain categories of costs that currently are subsidized and to reduce many other categories. With respect to plant costs, for example, support generally should be limited to a portion of the loop costs associated with customers in the non-competitive portion of the study area because costs in remote areas may be so high that they cannot be recovered from customers. Conversely, support for switching costs should be reduced substantially, if not eliminated completely in most cases. Switching support is premised on the theory that an ILEC's small customer base cannot support the costs of a switch, but the deployment of a competing switching facility by an unsubsidized competitor demonstrates the economic feasibility of operating a switch in that location without support.[48] Although the ILEC's switching equipment obviously will continue to be used in serving customers in the noncompetitive portion of the study area, the Commission

[47] The amount of high-cost support going to wireless CETCs in these study areas also should be reduced, if not eliminated entirely. Where a wireless CETC does not serve the portion of the study area for which the ILEC will be receiving support, it should no longer receive support. The situation is more complex where one or more wireless CETCs serve the portion of the study area for which the ILEC will be receiving support. The Commission has a number of options it may want to consider including requiring a cost showing comparable to that made by the ILEC or using competitive bidding to select one supported wireless provider in such areas.

[48] This assumes that an ILEC's switch is located in the competitive portion of the study area. In some circumstances, switching facilities located in the non-competitive portion of a study area may still warrant some support.

should presume that an ILEC will be able to recover those costs from its customers, just as they are in the competitive portion of the study area. The same is true for interoffice transport costs absent some demonstration to the contrary.

Similarly, the Commission should be able to reduce or eliminate support for most of the overhead costs associated with providing service. For example, there is no justification for subsidizing management salaries and many other corporate expenses when an unsubsidized competitor is providing service in the same study area and recovering those costs from its customers. Likewise, support distributed through Interstate Common Line Support (ICLS) and Interstate Access Support (IAS), which is not tied to any specific network costs, should be reduced significantly, if not eliminated entirely. In general, only costs associated with installation and maintenance of loop plant would continue to warrant subsidies and only if they would not otherwise be recovered through the provision of services over the network.

We anticipate that some ILECs will oppose these proposals on the grounds that they continue to need support even in competitive portions of a study area because they remain subject to POLR obligations. As a general rule, the Commission should reject these arguments. It is important to distinguish between the costs attributable to POLR requirements and the costs of operating in a competitive marketplace. In an area where a cable operator or other unsubsidized wireline competitor has built facilities and offers voice services, each providers' cost of operating and maintaining facilities is a cost attributable to *competition*. For example, any suggestion that the only reason an ILEC would maintain its facilities in a competitive area is because of a POLR obligation is based on a warped view of how competitive markets operate. One of the great benefits of facilities-based competition is that both incumbents and entrants have strong incentives to act in ways that will help attract and retain customers, *e.g.*, by maintaining their plant in good condition, independent of any legal obligations to do so.[49]

In considering which costs an ILEC should be able to recover through the provision of network services, the Commission should consider revenues from both regulated and unregulated services that are provided in the non-competitive portion of the study area. Even in high-cost rural areas, companies provide multiple services over a single network because it is more efficient than building stand-alone networks for each service they provide. There is no reason for the Commission to ignore those efficiencies and look solely at the costs and revenues attributable to voice services. As explained in a paper by Dr. Michael Pelcovits, "there is no reason to subsidize an ILEC to serve an area where revenue from voice, data and video service is sufficient to offset the costs of providing service."[50]

The Step 2 review process proposed here is a rigorous, fact-based process, as should be the case whenever an entity asks the federal government to subsidize its commercial activities. That said, NCTA encourages the Commission to seek comment on whether there are proxies that could be used to streamline the process. For example, the Commission could consider establishing a sliding scale that would reduce support by a certain percentage that varies with the level of competition in the area, *i.e.*, ILECs in areas with more extensive unsubsidized competition would see larger reductions in their high-cost support than ILECs in areas with less extensive unsubsidized competition.

---

[49] Once facilities-based competition is established in a particular area, there is no reason to think that either the incumbent or any new entrants will abandon the market. The reason for this is that the incremental cost of maintaining existing plant in order to stand ready to serve a customer that switches to a competitor is very low relative to the incremental revenue that could be earned if that customer switches back. But to err on the side of caution, the Commission may want to solicit comment on whether any safeguards are needed, beyond the existing Section 214 discontinuance process, in the unlikely event that one provider decides to leave the market following a Commission decision to reduce high-cost support.

[50] Pelcovits Subsidy Paper at 26.

III. ESTABLISHING THE PROCESS PROPOSED IN THIS PETITION WILL ENABLE THE COMMISSION TO CONSIDER WHETHER, AND HOW, TO FUND TARGETED BROADBAND PROGRAMS

Reducing unnecessary and wasteful high-cost support is a worthy goal for the Commission to pursue in its own right. In difficult economic times, reducing the USF assessment that appears on consumers' bills every month certainly would be welcome. As the contribution factor continues to escalate, it is more important than ever that the Commission begin to eliminate support where it no longer is needed.

But reducing the USF burden on consumers is not the only option available to the Commission. As the record in the *National Broadband Plan* proceeding demonstrates, achieving the congressional goal of universal access to broadband capability will be difficult to achieve without government programs dedicated to deploying facilities in unserved areas and promoting adoption by underserved populations. As the Commission considers NCTA's proposal to reduce support where it no longer is needed, it separately should consider whether, and how, it could redirect any savings from NCTA's proposal to provide targeted funding to programs that promote broadband deployment and adoption.

CONCLUSION

As described in this petition and the attached Eisenach Report, there is extensive wireline competition in many rural areas that are receiving federal high-cost support. Adoption of NCTA's proposal would provide a mechanism to reduce, and in some cases eliminate, unnecessary federal support to those areas where facilities-based competitors are able to offer service without support. While adoption of this proposal could have a significant revenue effect on ILECs and CETCs that are operating in these competitive study areas, this reckoning to account for competitive entry is long overdue and fully warranted by the technological and competitive developments described above. Simply put, where there is extensive unsubsidized