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

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337

COMMENTS OF THE UNITED STATES TELECOM ASSOCIATION

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Table of Contents

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	)	
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I. INTRODUCTION AND SUMMARY

USTelecom[1] is pleased to submit these comments on the Commission's Notice of Proposed Rulemaking[2] ("USF NPRM") on repurposing legacy universal service funding in high-cost areas and to shift support to broadband deployment in unserved areas. The Commission proposes to cap the overall size of the high-cost program at 2010 levels, re-examine the current regulatory framework for smaller carriers and phase out support for multiple competitors in areas where the market cannot support even one provider.

These comments also will address the Commission's Notice of Inquiry ("USF NOI")[3] on the use of an economic model to target support for areas where there is no private sector business case for carriers to provide broadband and voice services. The economic model developed in the National Broadband Plan estimates amount of additional funding that would be required to extend broadband service to U.S. housing

[1] USTelecom is the premier trade association representing service providers and suppliers for the telecommunications industry. USTelecom members provide a full array of services, including broadband, voice, data and video over wireline and wireless networks.
[2] Notice of Inquiry and Notice of Proposed Rulemaking, *In the Matter of Connect America Fund* (WC Docket No. 10-90), *A National Broadband Plan for Our Future* (GN Docket No. 09-51), *High-Cost Universal Service Support* (WC Docket No. 05-337), released April 21, 2010.
[3] *Id.*

units that presently are unserved by broadband meeting the national broadband availability target. The USF NOI seeks comment on how that model could be adapted to help estimate costs that would need to be addressed by universal service support intended to provide all Americans with broadband access.

Changes to the current high-cost mechanisms to support access to broadband and increased broadband adoption are necessary and USTelecom strongly supports moving forward in an expedited fashion on such changes. USTelecom member companies have done their part to increase access to voice and broadband services by continuing to invest tens of billions of dollars annually to deploy new broadband services and upgrading broadband facilities throughout their service areas. Despite those efforts, there are a number of areas where the costs of providing service will – at least in the foreseeable term – prevent the deployment of broadband service comparable to that available to the majority of Americans.

The National Broadband Plan, properly implemented, can help close the Digital Divide because its proposals recognize the importance of stabilizing the financial fundamentals by reforming universal service and intercarrier compensation, correctly targeting support at a more granular level, and focusing support on broadband deployment in addition to voice. And perhaps most importantly, the Plan recognizes the need for continued private investment.

An essential policy objective for a reformed Universal Service Fund must be the avoidance of requiring entities to provide facilities capable of providing particular services without adequately funding such requirements. Universal service funding cannot simply fund those areas that are currently unserved by broadband. There are

places that have broadband today only because of the existence of USF support for voice, which facilitates deployment of plant capable of providing broadband service.

It is very important to properly sequence and transition changes to high-cost support and intercarrier compensation mechanisms so as not to abruptly impact revenue flows and create hardships and unnecessary regulatory uncertainty for voice and broadband providers and lead to potential rate shock for consumers. A proper sequence would include the immediate implementation of several elements of intercarrier compensation reform, the establishment of permanent mechanisms for distribution of CAF support prior to implementing changes in current support to ILECs, and the initiation of the phase out of the remaining competitive ETC high-cost support as soon as possible. Interstate Access Support (IAS) should not be abolished until revenues from reformed USF and intercarrier compensation regimes can be reasonably predicted. And it is premature for the Commission to propose elimination of rate of return regulation.

It is certainly appropriate for the Commission to address the issue of the appropriate amount of universal service funding for high-cost areas, adoption, schools and libraries and rural health care. But since ILEC receipts from the high-cost portion of the Universal Service Fund have been stable for a number of years, and other portions of the Fund should be examined, it is premature to impose further caps on the high-cost program.

Whether a model is a useful tool in meeting the goal of ubiquitous voice and broadband deployment at a baseline speed depends on several factors, including the design of the CAF. So although it is appropriate for the Commission to begin discussing the design of a model and such discussion is properly being conducted through the Notice

of Inquiry process, it is difficult to make recommendations or draw hard and fast conclusions without more information on the CAF design. If a model is to be useful for any universal service mechanism (allocating either up-front funding or ongoing support), it should always yield results at the wire center and sub-wire center level. If a standardized geographic unit is employed, wire centers are preferable to other, larger geographic areas, because that is the unit by which the current universal service obligations will be replaced. The USF NOI discussion of models includes the suggestion to include revenues in the model design. While it is intuitively sensible to include revenues in the determination of whether a viable business case exists for the provision of voice and broadband services in a particular area, such inclusion carries with it many complications.

II. USTELECOM SUPPORTS CHANGES TO THE CURRENT HIGH COST MECHANISMS TO SUPPORT ACCESS TO BROADBAND AND INCREASED BROADBAND ADOPTION

For over a century, our nation's telecommunications network has helped define the fabric of American life. The nation's commitment to universal service has played a major role in America's economic and social development. The ubiquitous availability of a telephone in virtually every American home stands as one of the nation's landmark achievements of the last century and a testament to the efficacy and value of the commitment to universal service by policy makers in Congress and at the Commission.

But as recognized in the National Broadband Plan[4] this new century is the time to expand that vision and bring the benefits of high speed broadband to every corner of the

[4] *See* Federal Communications Commission (FCC), *Connecting America: The National Broadband Plan* (March 16, 2010) (*NBP*) at p 135. "Everyone in the United States today should have access to broadband services supporting a basic set of applications that include sending and receiving e-mail, downloading Web pages, photos and video, and using simple video conferencing."

nation while not retreating from the achievement of universal voice service. USTelecom represents a broad spectrum of the companies that have built much of the nation's existing broadband infrastructure. USTelecom member companies continue to invest tens of billions of dollars annually to deploy new broadband services and upgrade broadband facilities throughout their service areas.[5] Nonetheless, there are a number of areas where the costs of providing service will – at least in the foreseeable term – prevent the deployment of broadband service comparable to that available to the majority of Americans.

USTelecom supports the FCC's goal of providing broadband service to all Americans and the comprehensive process that went into developing the National Broadband Plan. Ensuring universal access to and adoption of high-speed broadband service is essential to our information economy, to creating American jobs, to driving the life-enhancing innovation that makes broadband so meaningful to our country. The broadband community agrees that we need to work together as a nation to ensure we connect those without access to broadband service.

The National Broadband Plan states that we already reach 95 percent of all Americans with broadband service.[6] Broadband providers have built facilities almost anywhere there is a reasonable business plan. About 290 million people have fixed line broadband capable of 4 Mbps.[7] And, unique in the world, of those people, 82 percent

[5] Our industry has spent half a trillion dollars over the past 10 years investing in high-speed broadband networks. FCC data show that 82 percent of U.S. households can choose from at least 2 wired broadband providers, and several wireless providers are planning national 4G rollouts over the next several years. This statistic indicating that 82 percent of U.S. households have a choice of broadband providers compares to about 40 percent across the European Union, and around 25 to 50 percent for larger EU members such as France, the UK, Germany and Spain.

[6] *See* NBP at page 20.

[7] *See* NBP at page 20.

have access to two or more fixed providers.[8] Ninety-six percent of business locations in the country have access to broadband over DSL, and 99 percent of health care locations with physicians have broadband at 4 Mbps or faster.[9] But approximately 14 million people, about 4.5 percent of the population, do not have fixed broadband service available.[10] USTelecom supports efforts to utilize universal service funds to help close this digital divide.

The National Broadband Plan, properly implemented, can help close the Digital Divide because its proposals recognize the importance of stabilizing the financial fundamentals by reforming universal service and intercarrier compensation, correctly targeting support at a more granular level, and focusing support on broadband deployment in addition to voice. And perhaps most importantly, the Plan recognizes the need for continued private investment. Such investment is supported by ensuring that the regulatory environment allows carriers to structure a business case that provides the opportunity for a reasonable return and thus attracts the capital required to build out and operate broadband facilities. Universal service funding and intercarrier compensation are major sources of revenue for companies serving high-cost rural areas, and so reforms to those mechanisms must be carefully and thoughtfully accomplished, always keeping in mind the business case for attracting private capital needed to meet the goal of universal broadband access.

An essential policy objective for a reformed Universal Service Fund must be the avoidance of requiring entities to provide facilities capable of providing particular services without adequately funding such requirements. The Commission must be

[8] *See* NBP at page 37.
[9] *See* NBP at page 20.
[10] *Id.*

careful to not impose such unfunded mandates. Universal service funding can form the basis for a social contract in which the government provides some funding in exchange for leveraging the private risk capital of providers to fulfill an important social goal by deploying facilities in order to offer services crucial to consumers and economic development – voice and broadband. Unfunded mandates would be an unfair exercise of the government's power in that contractual relationship. They distort competition and broadband investment. In the long run, unfunded mandates work to the detriment of consumers by creating unsustainable projects. The best way to ensure deployment of voice and broadband facilities in those areas in which there is no private sector business case to deploy broadband is to structure a clear regulatory framework that provides sufficient funding to allow providers to develop such a rational business case.

Moreover, if a provider is serving an area in which it is not the supported entity, it should be relieved of ETC, carrier-of-last-resort and dominant carrier obligations for voice and broadband in the supported area. The absence of the provision of support would negate the regulatory framework and the voice and broadband provider would operate according to the dictates of the market and its own business plan.

Areas in which deployment of facilities to provide voice and broadband services is uneconomic should be supported, and the support should be calculated using the same methodology in all places. Consumers should be neither penalized nor rewarded by the accident of the identity of their broadband provider, the granularity of the calculation of the support for their broadband provider, nor by the regulatory scheme under which that provider operates.[11] This is not to say that a one-size-fits-all approach is necessarily

[11] *See* National Broadband Plan, page 141, which states "While current funding supports phone service to lines served by price-cap carriers, the amounts do no provide an incentive for the costly upgrades that may

optimal, but that any tailoring of support mechanisms can and should be done in order to accomplish an equitable distribution of funding.

Universal service funding cannot simply fund those areas that are currently unserved by broadband. There are places that have broadband today only because of the existence of USF support for voice, which facilitates deployment of plant capable of providing broadband service. As the Commission notes, much of today's universal service high-cost funding, which is aimed directly at voice service, indirectly supports provision of broadband service.

But even a perfectly designed plan for universal service funding for broadband deployment implemented over a flawless transition could be undermined by anti-investment policies being considered in the Open Internet proceeding or by changes in the Commission's successful competition policy. The most successful universal service policy for broadband must rely on a legal and regulatory environment that encourages private investment, which can then be efficiently leveraged by a well constructed support program.

III. PROPER SEQUENCING OF CHANGES TO HIGH-COST UNIVERSAL SERVICE SUPPORT IS CRUCIAL TO A SUCCESSFUL OUTCOME

It is very important to properly sequence and transition changes to high-cost support and intercarrier compensation mechanisms so as not to abruptly impact revenue flows and create hardships and unnecessary regulatory uncertainty for voice and broadband providers and lead to potential rate shock for consumers. USTelecom

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be required to deliver broadband to these customers." Footnote 37 of the Endnotes in Chapter 8 of the National Broadband Plan expands on that point by stating "Funding levels for the larger carriers are based on a forward looking cost model that was designed to estimate the cost of providing circuit-switched voice services, it was never intended to address the investment necessary to extend broadband to unserved areas. In contrast, smaller carriers typically receive funding under formulas that allow them to recoup their actual costs of extending broadband to unserved areas, including the costs of deploying fiber and, for some companies, soft switches."

recognizes that these mechanisms are so complex and so intertwined that it is easy for policy makers to become paralyzed when attempting to substantially reform both in an integrated fashion. The National Broadband Plan attempts to untie this Gordian knot, and for the most part succeeds. However, certain elements of the timing proposed in the Plan and suggested in the USF NPRM add unnecessary complications and uncertainty to the intercarrier compensation and universal service reform efforts.

Such concerns about timing are especially significant in the context of proposed universal service and intercarrier compensation reform efforts. The roadmap laid out by the National Broadband Plan places proposals on how to refocus universal service funding to directly fund both broadband and voice services within a Notice of Inquiry, while efforts to identify how to cut funding via existing mechanisms are placed within a Notice of Proposed Rulemaking. Both of these items have already been released for comment. Meanwhile, intercarrier compensation reform efforts are not scheduled to begin until the fourth quarter of this year with consideration of a proposed framework for long term reform, and the Commission still has yet to implement interim measures to curb arbitrage. Commission designation of separate tracks for these interrelated reform efforts has produced uncertainty about whether disbursement of new funds will coincide with elimination of existing funds.

A. Intercarrier Compensation Reform Can and Should Begin Now

As USTelecom has stated previously,[12] there are several elements of intercarrier compensation reform upon which there is a strong level of consensus that can and should be implemented quickly. Those elements on which the Commission has a more than

[12] *See* Letter from Walter B. McCormick, Jr., President & CEO, United States Telecom Association, to Julius Genachowski, Chairman, FCC, CC Docket Nos. 01-92 and 96-45, (July 29, 2009 *Ex Parte*).

sufficient record and could immediately issue orders include long-standing issues such as addressing arbitrage such as phantom traffic and traffic pumping, and addressing application of the intercarrier compensation regime to Voice over Internet Protocol (VoIP) traffic. Soon afterward and concurrent with universal service reforms, the Commission could quickly address moving intrastate access rates to interstate levels. This substantial progress -- which must include, among other elements, a mechanism to address lost access revenues -- would help inform the Commission as to the full scope of universal service funding needs. There is more than a sufficient record for the Commission to take these recommended actions now by issuing orders. Implementing an incremental approach to intercarrier compensation by immediately taking these major steps would help develop momentum for further reform and demonstrate the Commission's commitment and ability to resolve any remaining intercarrier compensation issues.

Because intercarrier compensation and universal service are such significant sources of revenue for many companies serving rural consumers, disruption in or uncertainty about the future of these revenue flows could discourage plans for future investment of private capital in broadband facilities. Addressing a major portion of the intercarrier compensation puzzle by fixing uneconomic arbitrage, addressing the appropriate application of the intercarrier compensation regime to VoIP traffic, and harmonizing of state and interstate rates along with adopting appropriate revenue recovery mechanisms would help carriers plan for the future.

B. Establishing Permanent Mechanisms for Distribution of CAF Support Should be Accomplished Prior to Implementing Changes in Current Support to Incumbent Local Exchange Carriers

The USF NPRM proposes reductions in universal service funding to Incumbent

Local Exchange Carriers ("ILECs") and others to create headroom under a cap in order to repurpose current funding for direct support of broadband deployment. The USF NPRM explicitly states that "[t]he intent of these proposals is to eliminate the indirect funding of broadband-capable networks today through our legacy high-cost programs, which is occurring without transparency or accountability for the use of funds to extend broadband service."[13] The National Broadband Plan also proposes to transition intrastate access rates to interstate levels.[14]

But the precise nature and amount of repurposed funds so far remains undefined and uncertain. While the Commission is proposing almost immediate, definite and quantifiable reductions in Universal Service Fund support and intercarrier compensation revenues, its plans for the use of the funds made available are unclear. The proposed changes would allow companies to estimate with a high degree of certainty the reductions in USF and intercarrier compensation revenues, but currently fail to offer recipients a corresponding ability to project potential replacement revenues from a repurposed fund. Not only is the Commission just beginning to explore the bounds of a model approach through the Notice of Inquiry accompanying the USF NPRM, it acknowledges that it is trying to find an interim methodology to use prior to adoption of a more permanent approach.[15] So far the Commission has not put forward clear proposals addressing the eligibility requirements for the new Fund; the methodology for calculation of support; the mix of funding for operating expenses versus capital investment; the level of geographic

[13] *See* USF NPRM paragraph 53, page 22.
[14] *See* NBP page 148, recommendation 8.7, "The first step of the staged reform should move carriers' intrastate terminating switched access rates to interstate terminating switched access rate levels in equal increments over a period of two to four years."
[15] *See* Paragraph 43, page 18, of the USF NPRM "We seek comment on the best way to create an accelerated process to distribute funding to support new deployment of broadband-capable networks in unserved areas during the period we are considering final rules to implement fully the new CAF funding mechanism."

targeting of fund support; the service areas over which costs, revenues or a combination of both will be calculated; and a myriad of other questions that would at least provide an indication of which direction a particular companies' universal service revenues and intercarrier compensation revenues will head, let alone the amount of those revenues and the basis and time period over which they will be disbursed.

The sequencing and uncertainty regarding the substance of reforms currently leaves companies in the position of trying to assess the impact of not only one new system of universal service distribution, but actually trying to project possible revenues from two new systems and a reformed intercarrier compensation regime. This state of affairs unnecessarily injects uncertainty into companies' assessment of their future revenue flows, particularly when those companies have a greater dependence on universal service and intercarrier compensation revenues. Announced reforms could result in the freezing or pulling back of plans to use private capital to invest in broadband facilities in unserved and underserved areas.

To improve conditions in the near term, the Commission should quickly adopt two important suggestions to better target current high-cost support to the granular areas with the greatest demonstrated need, an issue on which it has a more than adequate record to address today. First, the Commission should stop its practice of classifying an entire state under the non-rural high-cost fund as either eligible or not eligible for support based on statewide average costs. Second, the Commission simultaneously should permit price cap carriers, on a holding company basis, to make a one-time election to calculate all of their support under the forward-looking mechanism.

These two, concurrent reforms could enable significant new broadband

deployment in unserved areas. The indirect funding of broadband-capable networks through legacy high-cost programs has been a demonstrable success in the areas in which sufficient funds have been provided. The lack of more granular targeting, however, significantly hinders companies' ability to provide access to telecommunications and broadband services in high-cost areas.

Some high-cost areas currently are obscured by averaging within a state or study area, denying those high-cost rural customers the benefits intended by the universal service program. Statewide and study area averaging create implicit subsidies that are no longer sustainable in today's competitive environment. States that contain high-cost areas but have lower costs on average are denied access to non-rural high-cost universal service funding for those high-cost areas. Within states, lower cost urban and suburban areas naturally tend to attract the most competitive entry, thus limiting the ability of the incumbent carriers to implicitly subsidize high-cost rural portions of the study area without suffering a significant competitive disadvantage. And of course, the stress placed by this regime increases as a company faces more competition in its lower-cost areas, and thereby has less revenue to internally subsidize its high-cost areas.

Furthermore, some carriers may have suffered from underinvestment by previous owners of the facilities in the past that can lead to a vicious cycle of underinvestment in the future.[16] Permitting price cap carriers to elect a one-time change to forward-looking costs permits carriers to escape this vicious cycle and make investments in facilities that support advanced services, thus benefiting consumers.

It makes sense for the Commission to try to ensure that Universal Service

[16] The artificially low cost characteristics of such areas resulting from underinvestment limit the amount of universal service support for which the carrier is eligible, leading to lower than optimal levels of investment in the future.

Funding supports broadband deployment sooner rather than later. If the transparency or accountability of the indirect use of legacy funds to extend broadband service on an interim basis remains a concern, the Commission can and should address those issues directly.

Targeting achieved with the two reforms above would facilitate comprehensive reforms contemplated by the National Broadband Plan. As a part of long-term reform efforts, it is certainly sensible to replace indirect funding of broadband facilities with direct funding targeted to granular, high-cost areas, and USTelecom supports this change. And it could be an even greater success if the Commission would quickly adopt suggestions to better target current high-cost support to the granular areas with the greatest demonstrated need, an issue on which it has a more than adequate record to address today. It is certainly sensible to replace indirect funding of broadband facilities with direct funding, and USTelecom supports this change. USTelecom supports the adoption of a permanent mechanism to directly fund broadband and voice. Such a mechanism should include appropriate transitions, and most importantly, impose no unfunded mandates on voice and broadband providers.

C. The Commission Should Begin the Phase Out of the Remaining Competitive ETC High-Cost Support as Soon as Possible

The Commission should act now to phase out the remaining CETC support (that support not addressed by the voluntary merger agreements submitted by Verizon Wireless and Sprint) under the legacy programs. This remaining CETC support should be phased out over the five year transition period suggested in the USF NPRM.[17] Unlike funding to ILECs, CETC funding does not go to carriers of last resort. During the

[17] *See* USF NPRM, paragraph 60, page 25.

dramatic growth of support to CETCs, nationwide telephone penetration has remained relatively flat.[18]

The NBP notes that "[i]n some areas today, the USF supports more than a dozen competitive ETCs that provide voice service, and in many instances, companies receive support for multiple handsets on a single family plan. Given the national imperative to advance broadband, subsidizing this many competitive ETCs for voice service is clearly inefficient."[19] Phasing out support labeled as "clearly inefficient" is a rational and responsible action.

Support to CETCs grew from $15 million to almost $1 billion between 2001 and 2006, while support to ILECs has been flat or even declining since 2003. Phasing out support for CETCs addresses the subsidization of multiple ETCs in the same market and protects consumers. Such a phase out is competitively neutral over an interim period as the Commission is now developing a new competitively neutral regime for the distribution of high-cost support. The phase out of CETC support should be completed in a timely manner to permit the maximum amount of funding to be available for support to voice and broadband services.

The phase out of high-cost support for CETCs need not hinge on implementation of the Commission's goal of this proceeding to reduce high-cost support to free up funding for an interim broadband distribution regime. Controlling the size of the Universal Service Fund in the context of ensuring that funding is sufficient and directed at fulfilling the purposes articulated in the Act should not depend on a proceeding to

[18] *See* FCC, *Telephone Penetration by Income by State* (May 2010) at p. 28 available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-297986A1.pdf (visited July 9, 2010) and Federal-State Joint Board on Universal Service, *Universal Service Monitoring Report* (2009) (*2009 FSJB Monitoring Report*) at p. 3-15 available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-295442A1.pdf (visited July 9, 2010).

[19] *See* NBP at page 148.

repurpose funding, but should be accomplished whenever appropriate – as is certainly the case for CETC support, which has done little to serve core universal service goals.

In the context of the Sprint and Verizon Wireless merger agreements, the request by Corr Wireless Communications to review the decision of the Universal Service Administrator to no reallocate the high-cost funding that Verizon Wireless and Sprint agreed to forego in their voluntary merger commitments should be denied. Not only is Corr incorrect as a matter of law and public policy, the Commissions proposal to phase out all CETC funding would make Corr's request to reallocate to other CETCs the funding currently provided to Verizon Wireless and Sprint to other CETCs moot.

IV. INTERSTATE ACCESS SUPPORT SHOULD NOT BE ABOLISHED UNTIL REVENUES FROM REFORMED USF AND INTERCARRIER COMPENSATION REGIMES CAN BE REASONABLY PREDICTED

Interstate Access Support ("IAS") is an important revenue flow for price cap companies serving as carriers of last resort in high-cost areas and should not be arbitrarily abolished as suggested in the USF NPRM. The USF NPRM notes that "[w]hen the Commission created IAS in 2000, it said that it would revisit the funding mechanism 'to ensure that such funding is sufficient, yet not excessive.' That reexamination has not occurred." [20] Before eliminating IAS funding, the Commission should conduct that reexamination to determine whether this funding is sufficient or excessive and institute adequate direct funding to replace lost revenues if deemed necessary.

IAS is provided to price cap study areas regulated under the CALLS plan. It directly impacts subscriber rates in that it is intended to offset common line costs that would otherwise be recovered through higher subscriber line charges ("SLCs"). In many instances consumers in those large study areas already suffer from inadequate amounts of

[20] *See* NBP page 147 and USF NPRM paragraph 57, pages 24-25.

universal service support because of the effects of forced implicit support due to state and study area averaging of high-support. Abolishing IAS without a successor intercarrier compensation plan and absent a new regime that would allow companies to estimate the amount of high-cost revenues they may receive would add to company uncertainty and discourage needed private investment in broadband deployment. Interstate access support for ILECs should be retained until an evaluation of the need for the support has been conducted and successor mechanisms are adopted and implemented.

V. THE COMMISSION SHOULD PROCEED WITH CAUTION WHEN CONSIDERING PROPOSALS TO ELIMINATE OF RATE OF RETURN REGULATION

The Commission appears to be proposing to eliminate rate of return regulation in order to be able to convert Interstate Common Line Support ("ICLS") to a frozen amount per line, which the Commission notes "would have the effect of limiting growth in the legacy high-cost program." Calculation of ICLS is based on a carrier's interstate common line revenue requirement. Such a fundamental change in regulation for small ILECs should be approached with caution. It is one thing for a carrier to voluntarily agree to receive ICLS on a capped and per-line basis. It is another thing for the entire body of rate-of-return carriers to be required to do so.

USTelecom does not object to the Commission exploring incentive regulation for carriers currently under rate of return regulation. Indeed, both the Commission and small companies themselves should recognize that two of the three types of rate of return regulation – rates based on projected costs and demand (classic rate of return regulation), rates based on historical costs and demand (included in section 61.39 of the Commission's rules) and the average schedules -- have some incentive elements. So it is an inaccurate view of the current interstate regulatory regime applied to small companies

to characterize it as without incentive elements.

That is not to say that other and potentially better incentive regulation plans cannot be developed for small companies.[21] USTelecom encourages the Commission to design incentive regulation plans appropriate to small ILECs. The Commission is correct that all carriers, even small ILECs serving high-cost rural areas, are subject to an increasingly competitive marketplace, and that their service offering are expanding beyond regulated services. Better incentive regulation plans can be designed to operate in the NECA pooling environment – as a matter of fact, pooling is an excellent way to share the greater risk inherent in incentive regulation. But until such plans are developed, it is premature to abolish rate of return regulation merely for the purpose of freezing ICLS payments.

VI. ILEC SUPPORT HAS BEEN STABLE

The USF NPRM proposes to cap incumbent LEC support at 2010 levels.[22] The Commission should recognize that ILEC receipts from the high-cost portion of the Universal Service Fund have been stable for a number of years. The main elements driving increases in Universal Service Fund size have been payments to CETCs prior to the imposition of the interim cap, and the extraordinarily rapid growth of low-income funding due mainly to the growth of payments to customers of prepaid wireless carriers. The Commission has addressed the CETC issue through the imposition of the interim cap and seeks to further rationalize universal service funding by proposing in the USF NPRM

[21]Small ILECs have unique concerns that are not necessarily optimally addressed in the FCC's current version of price caps. The existing price cap regime is appropriate for mid-sized and larger ILECs, but, if judged by their uniform decision not to elect it, the rate of return regime is more advantageous for small ILECs. The current price cap regime was designed for large companies, and even the smaller of the mid-sized companies recently adopting a version of the CALLS plan are orders of magnitude larger than the average small company.

[22] *See* USF NPRM, paragraph 51, page 21.

to phase out support for CETCs. And right now, the greatest source of growth in the Universal Service Fund is in the low-income program. The Commission has just begun the process of looking at low-income issues through its recent referral to the Joint Board of issues dealing with eligibility and verification, as well as opening up the question of how low-income support works in a broadband world.[23]

It is certainly appropriate for the Commission to address the issue of the appropriate amount of universal service funding for high-cost areas, adoption, schools and libraries and rural health care. Exclusive of any fund size increase due to intercarrier compensation reform, it must be recognized that the reforms to the fund can and should be accomplished within predetermined budget constraints. Necessary changes to the fund can be accomplished within a fund size no lower than the current amount and no greater than a modest increase over that amount.

Determination of the appropriate fund size should carefully balance the need for funding with the reasonableness of the burden placed on consumers through the collection mechanism. But given that the Commission has not even begun to examine a new, broader based collection mechanism; is just asking the Joint Board to examine low-income issues; and has not developed the distribution mechanisms for either the CAF or the mobility fund; it is premature to set an arbitrary number today for Universal Service Fund size and impose further caps on the high-cost program so it falls within that number.

[23] *See* Public Notice, *Federal-State Joint Board on Universal Service Seeks Comment on Lifeline and Link-Up Eligibility, Verification, and Outreach Issues Referred to Joint Board*, CC Docket No. 96-45, WC Docket No. 03-109, released June 15, 2010.

VII. THERE IS INSUFFICIENT INFORMATION TO ENDORSE OR REJECT THE USE OF A SPECIFIC MODEL AT THIS TIME

With the transition from legacy universal service mechanisms to one which supports voice and broadband services, the Commission has an ideal opportunity to reinvent the distribution of high-cost funding. Today's process is clearly broken and USTelecom looks forward to the changes that will accompany implementation of the CAF. Over the past several years the Commission has had experience with a model, embedded costs, portable per line identical support, various fund caps and limits, and also has investigated potential competitive bidding mechanisms. The reinvention of universal service should focus on providing sufficient funding to support viable business cases, and aim for equal treatment of all rural areas regardless of the technology or regulatory structure of the provider that serves them, while minimizing the burden on contributors to the Fund. The solution that best meets those goals should reject the strategies proven to be ineffective and harmful and may include the use of a model, competitive bidding, or a combination of both.

The USF NOI asks for comment on the use of an economic model to "help determine universal support levels in areas where there is no private-sector business case to provide broadband and voice services."[24] The News Release accompanying the USF NPRM and NOI suggests an even more ambitious goal "to precisely target support for areas where there is no private-sector business case for carriers to provide broadband and voice services."[25] Commendably, the Commission has focused on the correct goal – determining the amount of support required to induce private entities to risk their own capital to provide voice and broadband service in areas where there is no business case

[24] *See* USF NPRM and NOI, page 2.
[25] *See* FCC News Release "*FCC Kicks Off Universal Service Reform*" released April 21, 2010.

today.

In the context of addressing broadband availability, the National Broadband Plan commendably focuses on establishing support for deployment of broadband service at a baseline broadband speed to all consumers, before providing enhancements in areas where service at the baseline speed already exists.[26] This approach is spot on – Universal Service Funding for broadband should ensure ubiquitous access so that *all* households and businesses have an opportunity to subscribe to a baseline level of broadband service. The Commission can and should seek to address that goal both outside and inside of the universal service funding arena by motivating the use of private risk capital in conjunction with government support required to make a rational economic case for further broadband deployment. The goal of availability of service ubiquitously at a baseline speed – as well as the aspirational goal of having at least 100 million U.S. homes with affordable access to download speeds of at least 100 megabits per second[27] -- depends on the Commission taking actions that encourage private investment, rather than taking actions to disincent such investment, and providing a greater level of regulatory certainty and predictability.

Whether a model is a useful tool in meeting the goal of ubiquitous voice and broadband deployment at a baseline speed depends on several factors, including the design of the CAF. So although it is appropriate for the Commission to begin discussing the design of a model and such discussion is properly being conducted through the Notice of Inquiry process, it is difficult to make recommendations or draw hard and fast conclusions without more information on the CAF design. Among the many open

[26] *See* NBP, Chapter 8, page 135.
[27] *See* NBP, Chapter 2, page 9.

questions that remain is the extent to which the CAF will offer up-front funding for projects to deploy new broadband facilities to unserved areas versus recurring funding for existing or new broadband and voice facilities in high-cost areas. Moreover, the CAF will need to account for the impact on carriers if the Commission reduces existing universal service that has already been used to support broadband deployment in certain areas where such deployment otherwise would be uneconomic.

It also would be helpful to have further information on the competitive bidding process that may make use of a model. The National Broadband Plan recommends that "[t]he FCC should identify ways to drive funding to efficient levels, including market-based mechanisms where appropriate, to determine the firms that will receive CAF support and the amount of support they will receive"[28] Although it is suggested that a model be used to potentially determine reserve prices in areas in which competitive bidding is used, or model results be applied to determine support in an area that does not receive more than one bid, the lack of clarity about the competitive bidding process makes it difficult to evaluate a model and its potential usefulness in such a context.

As the Commission learned in the Rural Task Force process that evaluated the applicability of the HCPM to carriers classified as rural telephone companies, models are imperfect tools, particularly when applied to smaller areas which can be more greatly influenced by anomalous topographic or demographic conditions. Although it is generally acknowledged that modeling methodology has greatly improved in the last decade, models can play a role in determining support but should not be applied to the determination of high-cost support in a conclusory fashion unless and until it can be demonstrated that models can be refined to consistently replicate reasonable market

[28] *See* USF NOI, page 7, paragraph 10.

outcomes. Instead, the Commission should afford serious consideration to approaches that would offer communications providers the ability to provide actual data if the model strays too far from reality or would use model results to provide reasonable parameters for the Commission to implement a more market-oriented process.

While the best interim step would be to act now to target current high-cost support to granular areas with the greatest need (as described above), the Commission also may seek to experiment with using a new model to estimate the range of support that is and would be required to provide near-term, sufficient incentives for private entities to offer broadband service in high-cost areas. In particular, the Commission could determine the amount of unallocated high-cost funding available in a particular year, and set an initial benchmark level of support per new business or household connected for which funding was available, which would be offered only above and beyond an appropriate amount of private sector investment. The model could be useful in determining that initial level. Communications providers would be subject to a broadband deployment commitment proportionate to the amount of support received only if they voluntarily elected to receive new broadband deployment funding (presumably because the benchmark funding level would enable them to make a viable business case in unserved areas where they opted to receive support). Experience with that level of new-build support could be used to adjust the benchmark in future years as the areas that are marginally unprofitable today begin to receive service and the more challenging areas without service remain.

A model can be used as a tool in the implementation of the CAF, but the Commission's primary emphasis should be on developing an equitable and specific Request for Proposal (RFP) process by which companies decide whether or not to take on

the specified obligations to provide voice and broadband service. A clear explication of such obligations will memorialize the somewhat ambiguous social contract of today into an equitable and enforceable arrangement. Development of fair and appropriate scoring criteria and weighting of various elements is extraordinarily important and goes far beyond the simplistic ability to meet broadband speed requirements. As the Commission has discovered, the ability to provide emergency services, the continued economic viability of the recipient of the universal service funding support, the sustainability of the project, the quality of service, are all significant elements that must be taken into account.

VIII. USE OF REVENUES IN A MODEL

While it is intuitively sensible to include revenues in the determination of whether a viable business case exists for the provision of voice and broadband services in a particular area, such inclusion carries with it many complications. Revenues are difficult to define. Presumably the revenues that would be considered would be those generated by the customers in the area receiving support, but identification of such a subset of revenues could be difficult. Revenues, unlike the relatively fixed costs of constructing and operating broadband facilities, can be extremely variable, and may respond to, among other items, regulatory ratemakers, demographics of the target customer base, and changes to the market in areas not being supported that impact pricing and uptake in areas receiving support. And how would a model address changes in revenues over time?

Moreover, the inclusion of revenues for a service implies two things – that the service is being offered over the facility being supported and that the costs of providing the service are properly reflected in the model as well. Will the model assume that if a service can technically be provided over a facility it is actually being provided? Does this imply that companies receiving support will actually have a *de facto* mandate to

deploy a wide variety of revenue-generating services over their voice and broadband facilities, such as online advertising?

And while the baseline speed proposed in the National Broadband Plan does not support standalone video service, it is not unreasonable to predict that the baseline speed may be increased in future years up to a level that could support video. In that case, how would the model deal with the cost question – particularly in the area of video services? Would the model reflect the high cost of content acquisition by video providers other than large vertically integrated cable companies? How can a model be competitively equitable when the cost of content acquisition various so dramatically among providers? How would reflecting content acquisition costs impact the cost of content? Scarce universal service funding could end up being passed through to line the pockets of content providers and not fulfill the goal of continuing and extending the offering of voice and broadband service. Will public policymakers be comfortable with subsidizing all content, including content that some may find objectionable?

Moreover, with the inclusion of revenues in a model, how would any incentives to increase revenues be maintained? Support may reduce the incentive to increase revenues. And this issue highlights the question asked by the Commission about the length of time the model can be expected reliably to forecast expected revenues.[29] Presumably as penetration levels increase over times, revenues from providing a new service would be lower in earlier years than in later years – would the model take that into account and how often should revenue assumptions be updated? How would it take into account demographics – age and income for instance – that impact uptake and thus revenues? The inclusion of revenues in a broadband model is highly complex and

[29] *See* USF NOI, paragraph 39, page 16.

potentially problematic, but again, this depends on how the model is used in the process used to identify recipients of support and determine the level of their funding. The challenging questions posed by the potential inclusion of revenues in a model must be addressed in an open and transparent process that offers a meaningful opportunity for public comment and review.

IX. A MODEL MUST BE APPLICABLE TO A VARIETY OF GEOGRAPHIC AREAS

At least with respect to standalone, up-front funding for new broadband deployment, the best way to provide incentives for a company to take on new broadband build-out obligations associated with receipt of universal service support is to permit the company to define for itself the area in which it could construct a viable business case for provision of voice and broadband service. Such flexibility will result in the most efficient deployment of various technologies as well as the most efficient use of the Commission's scarce CAF dollars.

Moreover, if a model is to be useful for any universal service mechanism (allocating either up-front funding or ongoing support), it should always yield results at the wire center and sub-wire center level. If a standardized geographic unit is employed, wire centers are preferable to other, larger geographic areas, because that is the unit by which the current universal service obligations will be replaced. Wire centers are no less competitively neutral than any other alternative and reasonably reflect geographic, topographic and demographic realities of service areas. Wire centers make sense for all providers, but particularly so for small companies that serve smaller geographic areas. The same holds true for assessments conducted at the sub-wire center level, which allow to Commission to target support with an even greater degree of efficiency. Costs can

vary within a wire center, with areas farthest from the network node having costs many multiples of those closest to the node.

The Commission, in any event, should not allocate or distribute funds on the basis of counties. Counties bear no relationship to any network construction and could force providers to unnecessarily duplicate a competitor's network in supported places. Forcing a company to build out to the entirety of the unserved portion of a county that is partially, but not entirely, included in its service territory may force it into a Hobson's choice – either seek a large amount of funding to deploy altogether new networks outside of its service territory or not build out at all. Neither of those results serves the interests of the company, the consumer, or the Commission. A model should not drive a company to redefine its service area to be congruent with the model's construct. To the contrary, the model should support a regime where communications providers are encouraged to leverage existing facilities when engaging in new broadband deployment efforts. If a model is used in the determination of the distribution of CAF support, it must be able to accommodate the self-definition of areas to be supported.

X. A NEW MODEL IS NOT REQUIRED TO MOVE FORWARD WITH AN INTERIM SYSTEM

As explained in section II.B. of these comments (addressing the USF NPRM), one possible interim system would be to retarget the support provided to the price-cap carriers serving large study areas. Such support is now inadequate because of the impact of state and study-area averaging. The results of the mistargeting are documented in the National Broadband Plan which states that "[t]oday, roughly half of the unserved housing units are located in the territories of the largest price-cap carriers, which include AT&T, Verizon and Qwest, while about 15% are located in the territories of mid-sized price-cap

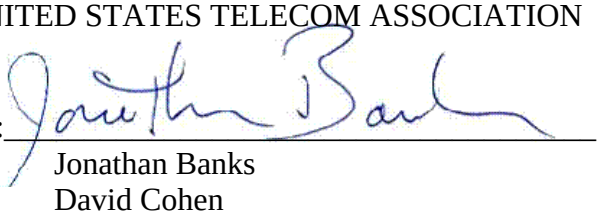
companies such as CenturyLink, Windstream and Frontier."[30] The price-cap companies are motivated to provide advanced services to their customers like other providers with higher rates of broadband deployment, but the poor targeting of support has handicapped the price cap companies in the pursuit of business plans that would feasibly permit such deployment. Revised targeting of support could alleviate this problem and could be accomplished with information available from the current HCPM. No new model would be required in the interim to implement such a change.

XI. CONCLUSION

USTelecom supports the proper implementation fundamental reform of the Universal Service Fund and intercarrier compensation. Even the most efficient and well designed Universal Service Fund properly and necessarily leverages private investment. That investment will be encouraged with smooth and coordinated changes to universal service and intercarrier compensation and the avoidance by the Commission of anti-investment policies.

Respectfully submitted,

UNITED STATES TELECOM ASSOCIATION

By: 

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[30] *See* NBP, Section 8.3, Universal Service, page 141. As noted in the end notes to Chapter 8 in the NBP, this estimate does not take into account Frontier's acquisition of Verizon lines, although the point remains the same.