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December 7, 2012

Via ECFS

Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: American Cable Association ("ACA"), Ex Parte Meeting on Connect America Fund, WC Docket No. 10-90 and High-Cost Universal Service Support, WC Docket No. 05-337

Dear Ms. Dortch:

On November 16, 2012, the price cap local exchange carriers ("LECs") comprising the ABC Coalition met with staff from the Wireline Competition Bureau to discuss their views of the Connect America Fund ("CAF") Phase II cost model. In an *ex parte* filed on November 20, 2012,[1] Robert Mayer, Vice President, Industry and State Affairs, US Telecom, described this meeting, including the the ABC Coalition's rebuttal of ACA's filings on the development of the cost model. The ABC Coalition apparently focused its arguments primarily on the differences between the greenfield model it proposed and the brownfield model proposed by ACA, contending that ACA's approach "has no clear policy rationale and is legally indefensible."[2] In this submission, ACA answers these arguments, as well as others made in the *ex parte* filing.

The principal claim the ABC Coalition makes about ACA's brownfield approach is that it does not permit recovery for capital expended by price cap LECs for investment in facilities made prior to the CAF, most of which were supported by the pre-CAF high-cost Universal Service Fund

1 *Ex Parte* Letter to Marlene H. Dortch, Secretary, Federal Communications Commission from Robert Mayer, Vice President, Industry and State Affairs, US Telecom, WC Docket No. 10-90, 05-337 (Nov. 20, 2012).

2 *Id.*, at 1. US Telecom's ex parte does not elaborate on its statement that ACA's approach is "legally indefensible." ACA disagrees with this contention.

("USF").[3] In effect, the ABC Coalition is claiming that the price cap LECs have ongoing depreciation expenses related to pre-CAF, primarily USF-supported investments and the CAF should be responsible for paying these expenses. These expectations for recovery are baseless and arbitrary.

At the outset, the price cap LECs unreasonably seek recovery under the CAF for prior investments made to serve locations in areas that were never supported by the high-cost USF fund.[4] From ACA's calculations, this represents approximately 14 percent of the proposed Phase II support for the price cap LECs and 32 percent for AT&T alone.[5] The price cap LECs provide no rationale for providing new government support to ensure recovery of these never "supported" investments.

As for locations in areas served by price cap LECs where historical (pre-CAF) investments were made, there are cogent reasons for not providing recovery under the Phase II regime:

- With respect to investments in the voice network (*e.g.*, last mile copper), these were made by the price cap LECs without them having any assurance that USF support would continue for a sufficient time to permit recovery.[6]

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3 Under ACA's brownfield approach, all new investments in broadband infrastructure required to meet the public interest obligations of the Phase II regime are recovered.

4 This is contrary to US Telecom's claim in the *ex parte* "that the fact that there are LEC facilities in these areas is attributable to current USF support."

5 ACA's calculations are based on a comparison between Study Area Codes where USF funding was received as documented in the Universal Service Administrative Company's 2011 high-cost USF support data and those included in the ABC Coalition's CAF Phase II subsidy proposal.

6 Because the Commission has been actively pursuing USF reform for many years, the price cap LECs have been on notice that fundamental changes in the distribution of support were possible and continuing support was not assured. *See e.g., High-Cost Universal Service Support et al.*, WC Docket No. 05-337 et al., Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, FCC 08-262, Appendix A, ¶¶32-34 (Nov. 5, 2008).

It also is important to note the U.S. Court of Appeals for the Fifth Circuit's *Alenco* conclusion: "The Act does not guarantee all local telephone service providers a sufficient return on investment; quite to the contrary, it is intended to introduce competition into the market. Competition necessarily brings the risk that some telephone service providers will be unable to compete. The Act only promises universal service, and that is a goal that requires sufficient funding of customers, not providers. So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well. Moreover, excessive funding may itself violate the sufficiency requirements of the Act. Because universal service is funded by a general pool subsidized by all telecommunications providers—and

- Many of these pre-CAF investments in the voice network were likely made years ago and may be fully or very close to fully depreciated.[7] There is no economic rationale for providing recovery anew for already depreciated assets.

- With respect to USF-supported investments in networks where the price cap LECs also deployed broadband capabilities (1.8 million locations under the ABC Coalition's proposal), the price cap LECs were under no regulatory obligation to use pre-CAF high-cost support for this additional purpose. Consequently, in making these broadband investments, they should have no expectation of receiving guaranteed government support. Decisions to invest in broadband were strategic choices the price cap LECs made based on their independent assessments of future profitability of the service and related regulatory policy direction.

The price cap LECs's arguments in favor of recovery for pre-CAF investments are not only baseless but arbitrary as well with regard to (1) the locations where they seek government guaranteed capital recovery for USF-supported investments, and (2) the amount of support for each supported location. The price cap LECs propose to forgo receipt of Phase II support for locations in areas where they received high-cost USF support either because these areas are served by competitive, broadband providers[8] or because these areas are below their proposed $80 floor. This includes areas where they have already invested in broadband. In fact, while many tens of millions of price cap LEC lines are supported by the high-cost USF, the price cap LECs propose to support fewer than 4 million locations under the Phase II CAF. In other words, the price cap LECs appear unconcerned about stranded investment for the vast majority of their pre-CAF, USF-supported investments, even in those instances where investments are not fully depreciated. Yet, in other areas, they insist full recovery is required.

In fact, AT&T and Verizon, two major recipients of high-cost USF and potentially of CAF, have announced they will overbuild with wireless 4G LTE in many areas that are CAF eligible and where high-cost USF was previously received.[9] Verizon has indicated it will tear out the copper if

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thus indirectly by the customers—excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market." *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000).

7 In any event, the ABC Coalition plan calls for recovery of past investments as if no portion of the network has been depreciated to date despite the fact that these investments have been made at various points in the past.

8 Many of these competitive locations with broadband have similar cost characteristics to areas eligible for subsidies.

9 *See* Statement of Verizon CEO at the Guggenheim Securities Symposium (June 21, 2012) ("And then in other areas that are more rural and more sparsely populated, we have got LTE built that will handle all of those services and so we are going to cut the copper

allowed, and AT&T at least will effectively strand it. These actions indicate they are unconcerned by stranded investment in areas where they received pre-CAF high-cost support or they may have sufficiently depreciated that plant. These market actions cannot be reconciled with the proposal of the ABC Coalition.

In addition, the price cap LECs' argument in favor of recovery for pre-CAF investments also is arbitrary with regard to the amount of support per location. Some of their plant is likely fully depreciated, while other plant is depreciated in varying degrees. In their proposal (as modeled by CQBAT), the price cap LECs do not directly account for the significant existing pre-CAF depreciation that is implied by their proposal and, for Verizon and AT&T, their market activities.[10] In effect, their proposal provides no specific correlation between actual pre-CAF depreciation and the amount of CAF support they seek.[11] This is a major shortcoming in an effort to develop an accurate cost model.

In sum, the price cap LECs have failed to demonstrate they are deserving of any capital recovery of legacy copper plant investment under the Phase II regime. Morever, they certainly have not provided any reasoned justification for either completely forgoing support in some areas and demanding anything but full support in others or precise evidence of what they should be entitled to recover even assuming recovery for pre-CAF investments should be permitted.[12]

off there. We are going to do it over wireless. So I am going to be really shrinking the amount of copper we have out there and then I can focus the investment on that to improve the performance of it"); and AT&T Analyst Conference 2012 presentation, "Laying a Foundation for Future Growth," at 41-42 (Nov. 7, 2012).

10 The CQBAT model uses accelerated depreciation, which provides greater upfront recovery, which is inappropriate for assets that are significantly depreciated.

11 ACA is cognizant that this issue is highly complex, involving such issues as levelized costing and residuals. If requested, it is prepared to engage in a further discussion with the Commission staff.

12 Assuming *arguendo* that recovery should be permitted for historical investments, there is no reason the price cap LECs should expect to receive any amount of support greater than that provided under the legacy high-cost program. This amount is far less that they seek to recover in the Phase II regime.

While ACA's proposed brownfield approach[13] does not provide for pre-CAF (capital recovery of legacy copper plant) investment, it does provide recovery for all new, CAF-related network investment and for all ongoing operating expenses of the entire network (voice and data) including:

- Sales and marketing
- General and administrative
- Network operations expenses (*e.g.*, labor, energy, fees)
- Maintenance across the entire network, including the last mile of copper, which accounts for the cost of:
    - Replacing portions of plant (other than retirement units)
    - Rearranging and changing the location of plant
    - Repairing material for reuse
    - Restoring the condition of plant damaged by storms, floods, fire, or other casualties.

By providing operating expense subsidies for these locations, these investments will not be stranded.

In addition to the capital recovery issue, the US Telecom *ex parte* raises a number of other issues. The following are ACA's responses:

US Telecom Claims:	**ACA Response:**
ACA "assumes, without discussion, that all existing LEC broadband plant can support 4 Mbps downstream/1 Mbps upstream without any new investment."	ACA makes no such assumption. ACA only assumes that broadband service exists where in fact 4 Mbps downstream/1 Mbps upstream broadband is provided. For those locations, ACA's brownfield build includes recovery for maintenance costs.
ACA "provides no support for upgrades necessary to meet 6 Mbps downstream/1.5 Mbps upstream requirements established in the *USF Transformation Order*."	ACA agrees. The Commission's order does not specify the extent of the obligation to provide service at these higher speeds, and so ACA had no basis for such a calculation.[14] ACA will consider the infrastructure requirements for those higher speeds when they are specified. It should be noted that the ABC Coalition CQBAT model, which ACA has used for purposes of comparison, also did not consider providing 6

[13] Based on runs using the brownfield scenario in the ABC Coalition's CQBAT model.

[14] *See Connect America Fund*, WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, FCC 11-161, ¶ 160 (2011).

	Mbps/1.5 Mbps service. In fact, it was "designed to ensure a minimum 4 Mbps down and 768 Kbps up."[15] Thus, the costs for the proposed greenfield FTTD build will increase as well to provide this enhanced performance.
ACA "assumes all LEC copper distribution plant will match to green-field modeled DSLAM locations and architectures."	ACA agrees, but this would only be a material issue if ACA were changing the service area definition, which it is not.
ACA "assumes, without discussion, that all existing LEC broadband distribution facilities support 4/1 broadband service."	ACA has stated that it assumes that the costs to ensure the required broadband service are covered by the price cap LECs' own loop reconditioning assumption used in the CQBAT model.
ACA "does not discuss how the necessary data on existing plant capabilities and value could be collected to properly run a brown-field model at a census block level."	ACA includes in its brownfield model recovery for the cost of reconditioning copper plant. Thus, regardless of whether data exists, recovery is provided. If the price cap LECs believe additional support is required, they should come forward and specify the amount.

In closing, ACA has submitted numerous filings in this proceeding with detailed data and documentation with the aim of assisting the Commission in developing an accurate cost model. It agrees with the price cap LECs' proposal that the model should reflect a fiber to the DSLAM build and that fiber feeder plant to the DSLAM will be needed where the qualified broadband service does not exist. However, for almost 50 percent of the locations the ABC Coalition proposes to support, qualifying broadband service exists, and, even where new fiber plant is required, existing copper lines to the premises will be reused. That describes a brownfield build. The key question joined by US Telecom in the *ex parte* is whether the price cap LECs should be entitled to recover the cost of investments made prior to the CAF regime. As set forth in this filing, the answer is "No." The price cap LECs should have no expectation of such recovery nor will the lack of recovery inhibit them from seeking support to provide broadband to the 3.8 million supported locations. ACA's proposed brownfield model gives them more than sufficient funding.

ACA looks forward to continuing to work with the Commission on the development of the cost model and welcomes the opportunity to respond to any questions about, and arguments against, its proposal.

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15 Comments of the United States Telecom Association et al., *Connect America Fund, High Cost Universal Service Support*, WC Docket Nos. 10-90, 05-337, n. 11 (July 9, 2012).

This letter is being filed electronically pursuant to section 1.1206 of the Commission's rules.

Sincerely,

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