June 20, 2013

Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Connect America Fund, Phase II Cost Model Virtual Workshop
WC Docket No. 10-90 – Finalizing Input Values

Dear Ms. Dortch:

The following is the response to "Finalizing Input Values for CAF Cost Model Cost Estimation Module" from Robert H. Mayer, USTelecom on Behalf of the ABC Coalition.

Query 1 Response:

The Coalition supports the use of the non-ACF default input values currently used in the cost estimation module input collections of CAM v3.1.2 for the final version of CAM. A general description of these non-ACF input values are found in 11 input tables described in Appendix 6 of the CAM Model Methodology document revised 5/22/2013, whereas the actual input values are found in the posted data sets mentioned above.

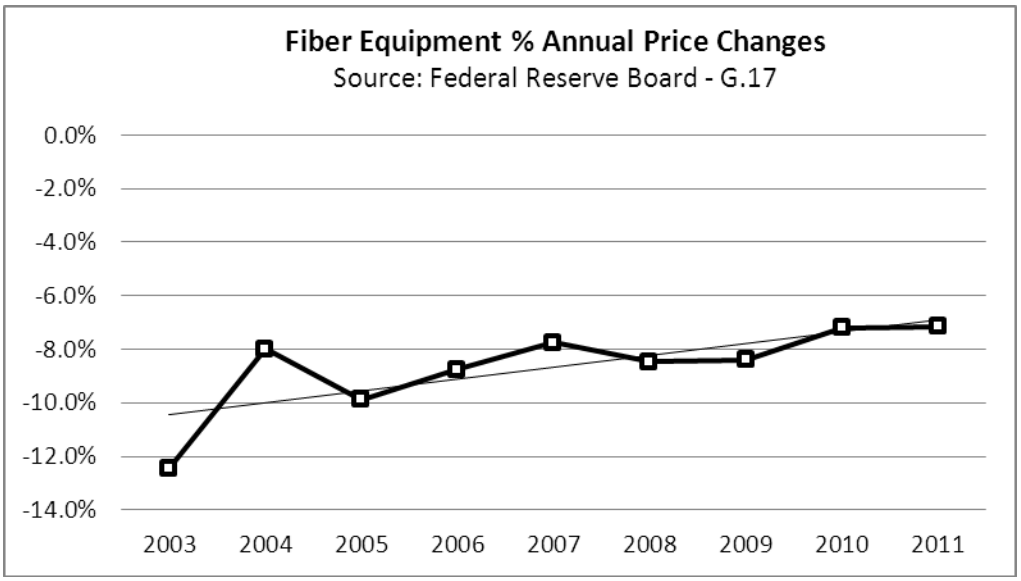
While the Coalition recommends no further changes to these input values, at least one commentator has offered suggested changes that the Coalition views as inappropriate. Specifically, ACA responded on May 21, 2013, to this virtual workshop topic proposing that all capital equipment price benchmarks be reduced by 9% per year for two years to reflect the passage of time between the data collection populating the material and installation costs in 2011 and the use of the CAM results at the beginning of 2014. This commentary by ACA is consistent with its ex parte filed on May 17, 2013. Apparently lacking a more nuanced set of price information for every capital equipment category, ACA viewed the use of a single price deflator across all capital equipment price benchmarks as a balance between expediency and fairness. The ACA proposed adjustments are not reasonable.

First, as the Bureau notes, if a party argues "that different inputs should be used, they should describe in detail their proposals and supply specific input values." The Capex input table provides the material and installation costs for the plant build developed in CAM. However, ACA's proposal refers generically to "capital equipment costs via a detailed set of tables outlining prices for various components of the network," which apparently refers to the Capex input table. While it seems apparent that ACA is not referring to installation costs, the Coalition still must guess what specific material input values in the Capex input table that ACA argues should be updated.

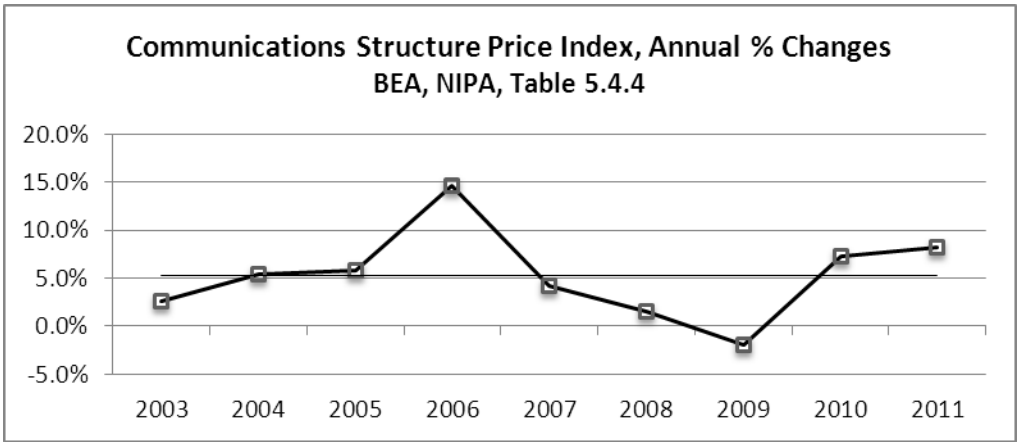
As the Commission well knows, given the large number of inputs needed for CAM, the input determination process takes a significant amount of time before the Commission is able to determine reasonable cost results, as was also the case in the determination of inputs for the synthesis cost model made in CC Docket No. 97-160. In addition, material costs for facilities and installation costs are generally more significant contributors to the costs developed by CAM than material costs for equipment. If the Commission were to consider updating material and installation costs used by CAM, all material and installation costs, and not just some cherry-picked subset, should be examined.

Second, although ACA discusses updating all telecommunications equipment prices, it asserts that it may be desirable to categorize equipment in some undefined groupings, but ACA does not find it expedient or fair to do so. Instead, ACA argues that all telecommunications equipment prices should be reduced by a common percentage. However, it is not apparent that prices for all communications equipment found in CAM, *e.g.*, cabinets, batteries, network routers and optical equipment would change at approximately the same rate over 2012 and 2013. Consequently, the Coalition views ACA proposal as exhibiting more expediency than accuracy.

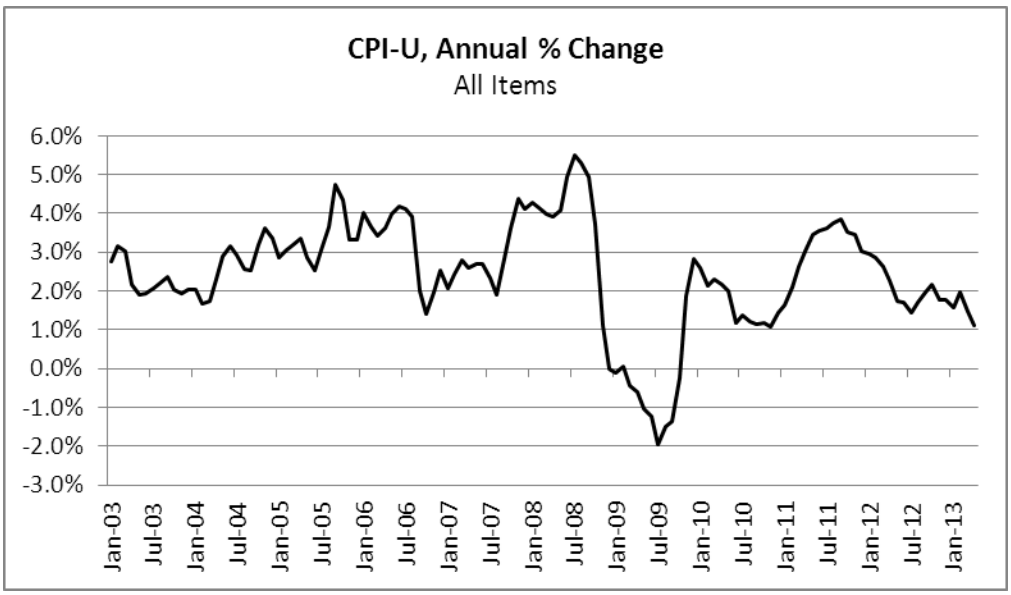
Third, ACA proposes to reduce equipment prices by 9% per year compounded for two years, *i.e.*, a cumulative reduction of 17.2%. ACA describes this annual percentage decline as the mid-point of the 4-year and 9-year Compound Annual Growth Rates of the price index of transmission, local loop, and legacy central office equipment developed by the staff of the Federal Reserve Board. This price index covers prices for fiber optic long-haul and local loop equipment. The attached chart shows the percentage declines in fiber equipment from 2003 to 2011, which the Coalition presumes is the information relied upon by ACA. In addition, this chart shows the trend line for the percentage price changes. Clearly, the percentage price declines for fiber equipment have been getting smaller over time. Based on this data, it is not reasonable to take averages, as apparently ACA has done, since such averages would project percentage price declines for 2012 and 2013 substantially larger than the strong trend implies. Using the trend line, a more reasonable estimate would be a decline of 6.4% for 2012 and a decline of 6.0% for 2013 or a 2-year decline of 12.0%. Thus, if the Commission wished to update fiber long-haul and loop equipment prices from the end of 2011 to the end of 2013, decreasing such material prices by 12% would be more appropriate than the rate recommended by ACA.



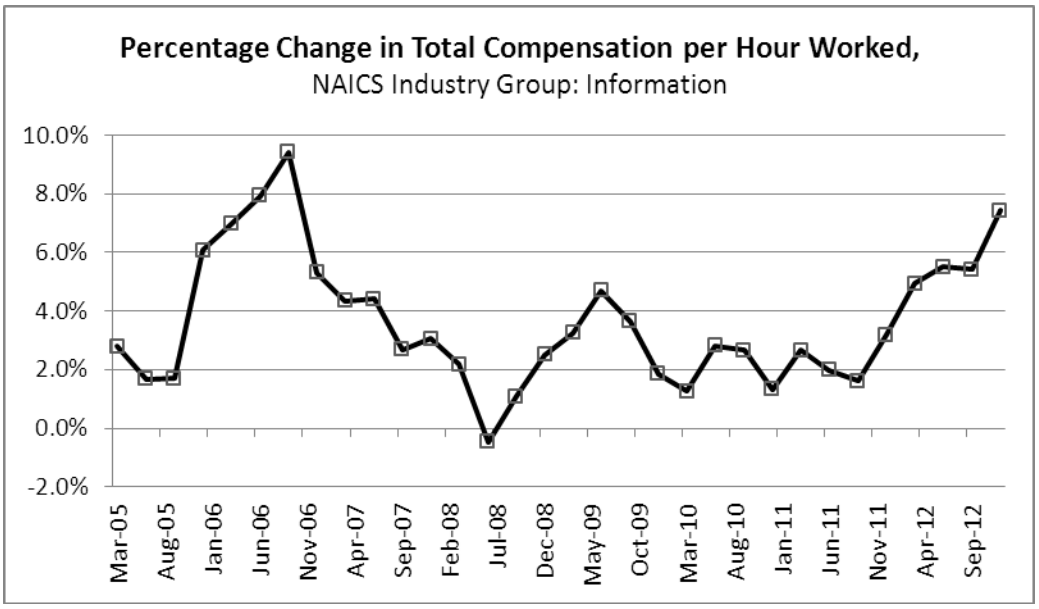
Now, the material prices found in the Capex input table include prices for more than just equipment needed for a FTTH build. Specifically, the Capex input table also includes material prices for communications structures—fiber cable of various types, poles, conduit, land and buildings. The only public price index known by the Coalition related to the material prices for structure found in CAM is the price index for private fixed investment in communications structures found in Table 5.4.4 of the U.S. National Income and Product Accounts published by the Bureau of Economic Analysis (BEA). Communications structures in this table include cable, poles, conduit and buildings. Over 2003 to 2011, this price index for communications structures has increased an average of 5.3% per year, although the average for the most current four years is 3.8%. The mid-point of the 4-year and 9-year averages is an annual increase of 4.5%. As can be seen in the diagram below, while there are significant year-to-year variations, the trend line is nearly flat. Clearly, the fiber-based price index recommended by ACA is not reasonable for communications structure. If Commission were to decide to update material prices for fiber cable, poles, conduit and buildings, a 2-year upward adjustment of 6.9% would be consistent with recent experience of the annual percentage change in BEA's communications structure price index.



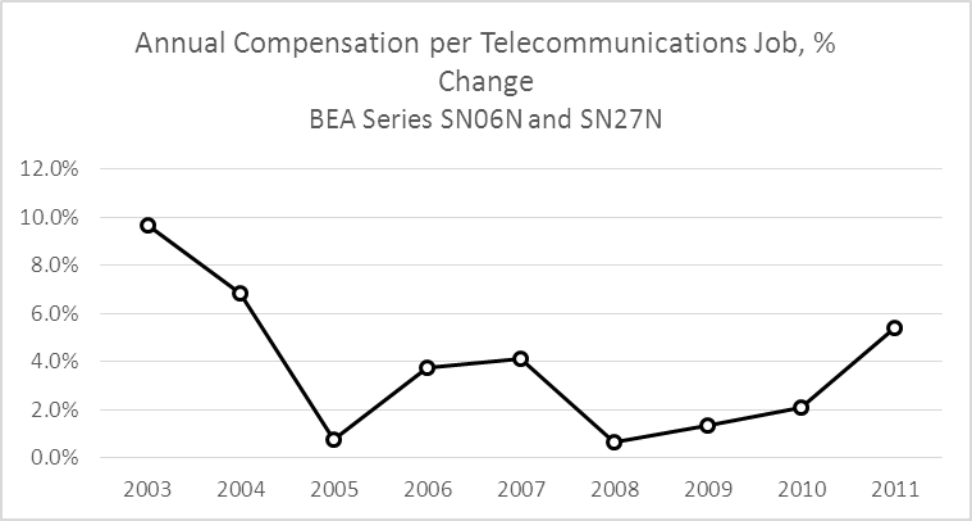
There are a number of candidates to use to update installation costs, which are based on numerous labor rates. The Consumer Price Index (CPI) published by the Bureau of Labor Statistics (BLS) measures inflation as experienced by consumers in their day-to-day living expenses and has often been used in private sector collective bargaining agreements to modify over the term of a contract the wages to unionized employees. The following chart shows the annual percentage changes in the CPI for all urban consumers from January 2003 to April 2013, which is the most currently available data published by the BLS. The average annual percentage change in CPI-U for 2012 was 2.1% and the average annual percentage change in CPI-U for 2013 based on the first 4 months of 2013 was 1.5%. Using these annual percentage changes, a 2-year adjustment increasing labor rates by 3.5% would be consistent with the CPI-U data.



Clearly, CPI-U does not directly measure inflation for total labor compensation or even just wages. The BLS conducts the National Compensation Survey, which provides employer costs for employee compensation. Using this survey, the BLS the shows the employers' average hourly cost for total labor compensation including break outs by wages and salaries, and total benefits. In addition, BLS breaks out data by major industrial groups based on the North American Industry Classification System (NAICS). The Information sector, which includes publishing, motion pictures, sound recording, broadcasting and data processing in addition to telecommunications, is the lowest level of industry detail that includes ILECs. The next chart shows annual percentage change in total compensation per hour worked for the Information sector from 2004 to 2012. The average annual percentage change for 2012 was 5.8%. Assuming that the 2013 percentage will be the same, the 2-year average adjustment would increase labor rates by 12%.



While the BLS data are imperfect matches, there exists another data source, published by the BEA that is a much better match. The BEA regional economic accounts provide statistics about employment and compensation for the telecommunications industry (NAICS industry 517). Using the BEA data, the average annual compensation per telecommunications job can be calculated. The percentage change in annual compensation per job is shown in the diagram below. The average annual percentage change for 2012 was 3.8%. Assuming that the 2013 percentage will be the same, the 2-year average adjustment would increase labor rates by 7.7%. If Commission were to decide to update installation costs by two years, then an increase of labor rates by 7.7% would be a reasonable estimate.



While the Coalition has provided some alternatives that improve on the suggestions made by ACA regarding updating material and installation costs, the Coalition still believes a less

speculative approach is more appropriate, which is not to make any inflation adjustment to the material and installation costs found in CAM.

Query 2 Response:
The Coalition agrees with the Staff's presumption to keep the non-ACF default input values static for purposes of developing final costs. To do otherwise would likely render the model-derived cost estimates unrealistic. Further, while making inflation adjustments to material and installation costs are feasible, CAM is ill-suited to incorporate any impact of material and installation cost changes over time. Also, it would be unreasonable and impractical to limit changes to only material and installation costs, since other economic valuation components may also change over time. For example, operating expenses are also likely to change over time.

ACA also contends in its virtual workshop comments that CAM should be modified to include a mechanism that reduces capital equipment prices over time. But, as discussed above, equipment prices are not the only material and installation costs that change over time. In fact, equipment prices are less significant contributors to the costs developed by CAM than other material and installation costs. Again, ACA's specific suggestion is neither practicable nor reasonable.

ACA also points to national regulatory bodies of other nations to support its contention that the capability to reflect a continuing inflation adjustment is warranted. Given that it is not reasonable to reflect a continuing inflation adjustment, it would be a waste of valuable resources to add a capability that should not be used.

Next, ACA appears to believe that incorporating a mechanism that reduces capital equipment prices over time is necessary because any capital investment that replaces capital that has served its economic life needs to reflect the future price at the time of replacement. But, there is no replacement cost calculation in the current, Greenfield version of CAM. Replacement cost calculations only occurred in version of the brownfield model, which was not adopted by the Commission.

Finally, ACA argued in its May 17, 2013 ex parte, but not in its virtual workshop comments, that because CAM uses the low end of project equipment lives, the Commission should use higher salvage rates for estimating the recoverable value of equipment at the end of its useful life. This recommendation should be rejected.

ACA's ex parte comments on salvage values explicitly discussed lives and salvage values for digital switches and copper cable. Since CAM does not develop any costs for digital switching or copper cable, these comments are irrelevant and should be disregarded. ACA expressed incredulity that any asset can incur additional costs at the end of its life. The Coalition is baffled that ACA is unaware that cost of removal occurs at the end of the useful life of an asset, and a

net salvage percentage reflects the salvage value of asset less the cost of removing the asset from the network so as to be able to receive that value. The use of negative net salvage percentages for some asset categories is reasonable and requires no change to the salvage values used in CAM.

Sincerely,

Robert Mayer
Vice President
Industry and State Affairs

cc: Katie King
Theodore Burmeister