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June 26, 2013

VIA ECFS

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

Re: American Cable Association (ACA) *Ex Parte* Filing on the Connect America Cost Model, WC Docket No. 10-90

Dear Ms. Dortch:

ACA submitted an *ex parte* filing and related comments in the virtual workshop on May 21, 2013 discussing input values for the Conect America Cost Model (“CACM”).¹ On June 20, 2013, the United States Telecom Association (“USTelecom”) filed an *ex parte* with responses to questions asked by the Wireline Competition Bureau (“Bureau”) in the virtual workshop, which also included responses to a number of ACA positions on input values.² It is clear from these comments that the question of input values requires careful estimation across the various cost categories to ensure the final model is accurate. In the comments below, we respond to a number of USTelecom’s responses.

Estimated Price Declines/Increases

ACA agrees with USTelecom that different price deflators/inflators should be used for different cost categories. ACA has previously proposed reducing costs by 9% per year to reflect the continued decline in pricing from the time the input values were estimated in 2011 to the expected distribution of CAF Phase II funding in 2014.³ This estimate was based on the historical pricing trend of a communications equipment index provided by the Federal Reserve.

¹ See *Ex Parte* filing of the American Cable Association, WC Docket No. 10-90, (May 21, 2013) (“ACA *Ex Parte*”).

² See *Ex Parte* filing of USTelecom, “Finalizing Input Values,” WC Docket Nos. 10-90 and 05-337, (June 20, 2013) (“USTelecom *Ex Parte*”).

³ See ACA *Ex Parte* at 2.

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USTelecom correctly stated that this trend would not be applicable to the labor component of costs in the model. It also provided its own estimate of 6.0%-6.4% price declines per year for fiber equipment.⁴ While ACA and USTelecom do not agree on the most appropriate benchmark or methodology that should be used to determine for forecasted future price decline for equipment, both parties do agree that communications/fiber equipment prices will decline from 2011 to the start of CAF Phase II and that the current estimates will not be accurate. Accordingly, the Bureau should modify the input values to reflect these expected declines. ACA continues to believe that the Federal Reserve estimates included in our May 21, 2013 *ex parte* are a credible and accurate source.

Additionally, USTelecom provides three benchmarks for increasing labor costs ranging from 2-year upward adjustments of 3.5% to 12%.⁵ The high end of this estimate is based on data from the North American Industry Classification System (“NAICS”) Information sector, which includes industries such as publishing, sound recording, and data processing, which are not relevant benchmarks for labor costs associated with communications equipment installation. The low end is based on changes in the overall Consumer Price Index (“CPI”) for urban consumers published by the Bureau of Labor Statistics (“BLS”), which is also too broad of a measure to be an accurate estimate of the applicable labor costs.

The final measure proposed by USTelecom is a two-year increase of 7.7% , or 3.8% per year, based on statistics provided by the Bureau of Economic Analysis (“BEA”) on employment and compensation in the telecommunications industry.⁶ While this would be a more accurate measure than the first two benchmarks, it is still flawed as it includes wages for non-installation job roles in the telecommunications industry. Much of this data would not be applicable for estimating changes in equipment installation labor costs.

A more reasonable approach would be to look at wage changes for ‘Telecommunications Line Installers and Repairers’ and ‘Telecommunications Equipment Installers and Repairers, Except Line Installers,’ which are reported by the BLS, and include employees who “install and repair telecommunications cable, including fiber optics” as well as those who “set up and maintain devices or equipment that carry communications signals, connect to telephone lines, or access the Internet.”⁷

⁴ See USTelecom *Ex Parte* at 2.

⁵ *Id.* at 4.

⁶ *Id.* at 5.

⁷ See Bureau of Labor Statistics, *Occupational Outlook Handbook – Telecommunications Equipment Installers and Repairers Except Line Installers* <http://www.bls.gov/ooh/installation-maintenance-and-repair/telecommunications-equipment-installers-and-repairers-except-line-installers.htm>. See also Bureau of Labor Statistics, *Occupational Outlook Handbook – Line Installers and Repairers*

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Using BLS reported data, the average hourly wage for these two employee categories grew at an annual rate of only 1.26% between 2010-2012, while the median hourly wage for these two categories grew at only 0.19% per year over the same period.⁸ This more accurate and applicable data source suggests that increases in labor costs over the period are negligible and are significantly lower than the 3.8% annual increase in labor costs estimated by USTelecom.

In aggregate, we believe that declining costs are not an unreasonable expectation for a forward looking deployment model, based on an efficient operator using FTTH technology. From 2004 to 2010, Verizon estimated a 12% annual decrease in the cost to pass each household in its FiOS deployment.⁹ More recently, Google continues to innovate in its Google Fiber deployment, indicating as recently as May 2013 that the company expects to continue to partner with cities and utilities to keep costs down and earn a profit without any tax breaks or subsidies.¹⁰ Verizon's cost estimate includes both equipment and labor, and this trend coupled with the recent increased deployment innovation from firms such as Google, suggest that ACA's original recommendation of 9% reduction in costs per year remain consistent with recent trends.

Continuing Price Adjustments for Replacement Assets

ACA previously suggested that the model should be modified to include a mechanism that reduces capital equipment prices over time at a standard rate to reflect the fact that replacement costs will be different from upfront costs. There is significant precedent for including such a mechanism in cost models adopted by other national regulatory authorities. USTelecom dismissed this recommendation indicating that "there is no replacement cost calculation in the current, Greenfield version of CAM."¹¹ This is not accurate, as the equal life group survival curve methodology assumes that a certain proportion of each asset is retired and replaced each year, resulting in a steady state asset base. These future replacement costs are included in the estimation of levelized costs, and contrary to USTelecom's assertion that "it is not reasonable to reflect a continuing inflation adjustment," the effects of price changes over time do have an impact on estimated costs.¹²

<http://www.bls.gov/ooH/installation-maintenance-and-repair/line-installers-and-repairers.htm#tab-5>.

⁸ See Bureau of Labor Statistics, *Occupational Employment Statistics* <http://www.bls.gov/oes/tables.htm>.

⁹ See *Ex Parte* Filing of Verizon, WC Docket No. 09-51 (Aug. 27, 2009).

¹⁰ See CNET, Google Exec Sees Google Fiber as a 'Moneymaker' (May 30, 2013), available at http://news.cnet.com/8301-1023_3-57586894-93/google-exec-sees-google-fiber-as-a-moneymaker/.

¹¹ See USTelecom *Ex Parte* at 6.

¹² *Id.*

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Salvage Values

USTelecom disagreed with ACA's proposal to adjust the salvage rates from their current low end of the salvage value to the high end.¹³ ACA's proposal is based on the fact that the model is currently using the low end of the asset life range estimates, and accordingly, the assets will likely retain a greater proportion of their salvage value. USTelecom did not directly respond to the ACA's comments, but rather dismissed them because the examples used were not based on fiber-to-the-home asset categories. ACA contends that the original justification remains applicable.

If the low ends of useful life ranges are to be used, then one would expect that the salvage rate would be higher than the low end of the salvage rate range. For example, the CACM assumes that motor vehicles will need to be replaced after 7.5 years, rather than the high end of the useful life range of 9.5 years. A motor vehicle replaced in 7.5 years is more likely to have recoverable value than a motor vehicle replaced in 9.5 years. Therefore, the salvage rate for an 7.5-year-old motor vehicle should not be the low value of 10% but rather the high value of 20%.

Further, using the low end of salvage rates distorts costs even more for assets that have a negative salvage value. ACA recognizes that there are costs associated with retiring assets at the end of its life; however, USTelecom's position that the low end of these retirement costs should be included in the model is not justified. As previously stated, it is not clear why the model should include any additional costs at the end of the asset lives, especially given that the modeled operating expenses provide funding for certain repairs and replacements. These negative values increase the depreciation expenses, resulting in higher ACFs and therefore greater annual levelized costs for each of the asset categories with negative salvage rates. Including these negative salvage values overstates and double counts certain retirement costs.

Consequently, ACA reiterates its recommendation that the future net salvage rates used in the CACM be modified in two ways: (1) for asset classes where the high end of the salvage rate range is positive, the Commission should adopt the high end of the salvage rate range, and (2) for asset classes where the high end of the salvage rate is negative, the FCC should adopt a salvage rate of zero.

¹³ See *id.* at 6-7.

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Should you have any questions about ACA's analysis, please contact me.

Sincerely,



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