KELLEY DRYE & WARREN LLP
A LIMITED LIABILITY PARTNERSHIP

WASHINGTON HARBOUR, SUITE 400
3050 K STREET, NW
WASHINGTON, D.C. 20007-5108

(202) 342-8400

NEW YORK, NY
LOS ANGELES, CA
CHICAGO, IL
STAMFORD, CT
PARSIPPANY, NJ

BRUSSELS, BELGIUM

AFFILIATE OFFICES
MUMBAI, INDIA

FACSIMILE
(202) 342-8451
www.kelleydrye.com

DIRECT LINE: (202) 342-8518
EMAIL: tcohen@kelleydrye.com

January 8, 2014

REDACTED – FOR PUBLIC INSPECTION

VIA HAND DELIVERY AND ECFS

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

Re: American Cable Association (ACA) *Ex Parte* Filing on Connect America Fund Phase II Cost Model, WC Docket 10-90

Dear Ms. Dortch:

The American Cable Association (ACA) hereby submits the attached letter in response to ex parte filings submitted by US Telecom on November 13, 2013 and November 20, 2013. ACA's letter contains Confidential Information and is being filed pursuant to the Third Protective Order (DA 12-1418) in the above-referenced proceeding.

Pursuant to the terms of the Third Protective Order, one copy of the filing containing Confidential Information and two copies of the Redacted version are being filed with the Office of the Secretary. The Redacted version is also being filed electronically through the Commission's Electronic Comment Filing System. In addition, two copies of the Confidential version are being delivered to Katie King of the Wireline Competition Bureau.

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Please contact the undersigned should you have any questions concerning this filing.

Sincerely,

Thomas Cohen

Thomas Cohen
Kelley Drye & Warren, LLP
3050 K Street N.W.
Washington, DC 20007
202-342-8518
tcohen@kelleydrye.com
Counsel for the American Cable Association

cc: Carol Mattey
Steve Rosenberg
Amy Bender
Katie King

KELLEY DRYE & WARREN LLP
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Re: American Cable Association (ACA) *Ex Parte* Filing on Connect America Fund Phase II Cost Model, WC Docket 10-90

Dear Ms. Dortch:

In this filing, ACA elaborates on its submissions on the Connect America Fund (CAF) Phase II Cost Model (CAM) and the particular issue of the support threshold. As part of its discussion herein, ACA responds to arguments made by US Telecom in two filings addressing support thresholds: on November 13, 2013, US Telecom proposed an approach for setting the upper support threshold;[1] and on November 20, 2013, US Telecom responded to an ACA filing, arguing for an alternative approach to setting the lower support threshold.[2]

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1 *See* Letter from Robert Mayer, Vice President Industry and State Affairs, US Telecom, *Additional Input to the Cost Model Virtual Workshop 2012*, WC Docket No. 10-90 (Nov. 13, 2013) ("Nov. 13 *Ex Parte*").

2 *See* Letter from Robert Mayer, Vice President Industry and State Affairs, US Telecom, *Response to ACA's September 24th Ex Parte Regarding USTelecom's September 2nd Ex Parte*, WC Docket No.. 10-90 (Nov. 20, 2013) ("Nov. 20 *Ex Parte*").

As discussed below, there are a number of flaws in US Telecom's rationale underlying its contention that the lower support threshold range should be $40.83 to $54.83. ACA has filed data supporting a lower support threshold of $64,[3] and it continues to believe that input best reflects actual market experience, modeling practice and Commission policies.

In a September 3, 2013, filing, US Telecom proposed a range of revenue benchmarks to employ if a "revenue-based approach" is used to calculate the lower support threshold for CAF Phase II. US Telecom's range of $40.83 to $54.83 was calculated using data collected from a confidential rate survey of high-speed Internet providers, an assumed rate of $30 for voice service, and assumptions for take rates for broadband-only and broadband-voice bundle subscribers.[4] ACA agrees with the approach of using actual broadband rates to set the lower support threshold. However, ACA takes issue with a number of aspects of US Telecom's methodology in determining the revenue benchmarks. Taken together, these methodological flaws lower the support threshold so significantly that it will lead to the inefficient allocation of CAF Phase II subsidies.

The FCC should not use the promotional price of broadband as the CAF Phase II lower support threshold because a number of factors mitigate the impact of promotional pricing on a revenue-based benchmark.

US Telecom argues that ACA's approach of using only non-promotional rates to set the revenue benchmark is flawed,[5] setting the lower support threshold artifically high. ACA does not dispute that promotional rates for broadband are available and used by customers, which would translate into lower average revenue per user (ARPU). However, there are several reasons why using promotional rates is not appropriate for setting the lower support threshold for the cost model.

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3 *See* Letter from Thomas Cohen, Counsel to the American Cable Association, *American Cable Association Ex Parte* Filing in the Virtual Workshop in Response to the Public Notice (DA 13-1136) on the Connect America Cost Model, Attachment at 10, WC Docket No. 10-90 (June 12, 2013) ("ACA *Ex Parte*").

4 *See* Letter from Robert Mayer, Vice President Industry and State Affairs, US Telecom, *Rebuttal of the American Cable Association Ex Parte Filing in the Virtual Workshop in Response to the Public Notice (DA 13-1136) on the Connect America Cost Model*, WC Docket 10-90, at 4-5 (Sept. 3, 2013) ("Sept. 3 *Ex Parte*").

5 "The major concern with [the ACA's] estimate is the lack of any recognition that promotional rates are an important part of Internet pricing." Nov. 20 *Ex Parte* at 2.

Relying on a confidential rate survey, US Telecom recommends a benchmark range for broadband-only prices of $28.54 to $46.03.[6] The lower figure is the unweighted average of promotional rates charged for broadband by **CONFIDENTIAL CONFIDENTIAL** broadband providers, and the higher figure is the unweighted average of non-promotional rates charged by **CONFIDENTIAL CONFIDENTIAL** providers (which includes the **CONFIDENTIAL CONFIDENTIAL** that offer promotional rates).[7] ACA does not take issue with the findings of the rate survey but believes the FCC should take into account that only a minority of subscribers in CAF Phase II-eligible locations will receive promotional rates for broadband for two reasons.

First, promotional rates are by definition temporary. Of the **CONFIDENTIAL CONFIDENTIAL** providers offering promotional rates, **CONFIDENTIAL CONFIDENTIAL** offer promotional rates that are good for no longer than **CONFIDENTIAL CONFIDENTIAL** months, of which **CONFIDENTIAL CONFIDENTIAL** offer promotional rates that are good for **CONFIDENTIAL CONFIDENTIAL** months or less.

Table 1. Broadband Providers Offering Promotional Rates, Organized by Expiration Date of Promotional Rates[8]

CONFIDENTIAL

CONFIDENTIAL

If most providers' promotional rates are only good for **CONFIDENTIAL CONFIDENTIAL** months, then any broadband subscribers signing up in year 1, 2 or 3 of the 5-year CAF Phase II funding period will pay non-promotional rates for the majority of their time as broadband subscribers. Given the pent-up demand for broadband in areas that lack broadband, it

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6 *See* Sept. 3 *Ex Parte* at 5.

7 *See* US Telecom 4/1 HSI Rate Analysis, at 1, in Telogical Systems report included as part of Sept. 3 *Ex Parte*.

8 *See* High Speed Internet Report - National View - Summary- July 2013, at 7, in Telogical Systems report included as part of Sept. 3 *Ex Parte*.

is likely the majority of subscribers over the five-year funding period will sign up for broadband in the first three years.

Second, because CAF Phase II-eligible areas are by definition served by no broadband providers[9] other than the local price cap local exchange carrier (LEC), subscribers who are unhappy with paying the higher non-promotional rate after the term of their promotional rate expires have only two choices: pay the higher rate or cancel their wireline broadband subscription altogether. While many broadband providers extend promotional rates when subscribers threaten to cancel, this practice is unlikely to be common in areas where there is no broadband competition to the price cap LEC. Even if broadband providers may offer uniform promotional prices nationwide, their policies on extensions of these deals are typically dictated by the competitive dynamics of local markets.

Finally, ACA notes that last April, the Commission issued an Order[10] on the form and content of a survey of urban rates for fixed voice and broadband residential services to be used to ensure rural rates are comparable and that the support provided by the CAF is adequate. As part of that decision, the Commission directed providers to report stand-alone, non-discounted rates for these services.[11] Comparability will not be determined by discounted or promotional offerings. Since price cap LECs will not be required to offer the same promotional rates in rural areas that they charge in urban areas, the Commission should not assume that price cap LECs will offer promotional rates to rural subscribers in the future. Therefore, the Commission should minimize the weight it gives to promotional rates if using a revenue-based approach to set the lower support threshold.

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9 The FCC has established that mobile broadband should not be considered an unsubsidized competitor for the purposes of determining CAF Phase II eligible areas. *See Connect America Fund et al.*, WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 26 FCC 17663, ¶ 104 (2011) (USF/ICC Transformation Order), pets. for review pending sub nom. In re: FCC 11-161, No. 11-9900 (10th Cir. filed Dec. 8, 2011).

10 *See Connect America Fund*, Order, WC Docket No. 10-90, DA 13-598 (Apr. 3, 2013).

11 *Id.*, ¶¶ 13, 20.

The FCC should use 90% as the assumed take rate for broadband subscribers, not 80% as recommended by US Telecom.

US Telecom has endorsed the principle that the FCC should not use one take rate for estimating costs and a different take rate for estimating expected revenues.[12] At the same time, US Telecom has repeatedly argued that the take rate used to estimate costs (90%) is not appropriate for estimating revenues.[13]

In the CAM, the take rate used to estimate the cost of providing voice service is the same as the take rate used to estimate the cost of providing broadband service: 90%. That is, 90% of eligible locations are assumed to require VoIP gateways. Following the principle that the Commission should not use one take rate for estimating costs and a different one for estimating expected revenues, the take rate used to estimate voice revenues should be 90%.

Further, as ACA demonstrated in a previous filing,[14] the broadband take rate at the end of the five-year CAF Phase II funding period is expected to be approximately 90%. This take rate is based on mapping the current broadband penetration rate onto the Gompertz mathematical model for forecasting technology adoption and projecting five years out from the start of CAF Phase II funding in 2014.

US Telecom objects, stating that the overall broadband penetration rate is not the appropriate rate to use to determine expected demand for broadband in CAF Phase II-eligible areas. Rather, the rural broadband penetration rate is the appropriate benchmark to use.[15]

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12 *See* Sept. 3 *Ex Parte* at 2. "Nevertheless, the Coalition agrees that the FCC should not use one take rate for estimating costs and a different take rate for estimating expected revenues."

13 *See* Nov. 20 *Ex Parte* at 3-4. For instance, US Telecom argues that the take rate for broadband-voice double-play should be 60% without evidence. ("Lacking any good data in the context of CAF-qualifying locations, the Coalition selected an average take rate for voice services of 60%."). *Id. See also* Sept. 3 *Ex Parte* at 3.

14 The methodology is discussed in ACA *Ex Parte* at 6-8. For clarification's sake, the "overall curve" we refer to is Exhibit 3R: Broadband Adoption Curve in Omnibus Broadband Initiative, *The Broadband Availability Gap: OBI Technical Paper No. 1*, at 47.

15 *See* Nov. 20 *Ex Parte* at 3-4.

But the rural broadband penetration rate cannot be used in isolation. The penetration rate of broadband in rural areas is artificially suppressed by the disproportionate portion of rural Americans that have no access to broadband at all. Once you eliminate the rural Americans who have no access to broadband, the current rural broadband penetration rate becomes statistically the same as the overall broadband penetration rate: 68% for rural areas vs. 70% for all areas.[16] Plotted on the Gompertz curve, the broadband take rate at the end of the CAF Phase II funding period remains the same: approximately 90%.

The FCC should determine the support thresholds for CAF Phase II based on a revenue-based benchmark for the lower threshold, not a service-based benchmark for the upper threshold.

In its Nov. 13 *Ex Parte*, US Telecom argues that using a revenue-based benchmark is unworkable because "the FCC does not have any data concerning the ARPU of any stand-alone voice/broadband service or combinations of voice and broadband service" and that "any ARPU data collection would also add lengthy and unnecessary increases to the timeline for CAF 2 model inputs approval and the ultimate disbursal of CAF 2 funding."[17] Instead, in this filing and another filing,[18] US Telecom argues that a "simpler approach"[19] would be to set the upper

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16 The current rural broadband penetration rate is 62% and the overall rate is 70%, according to Pew Research Center's Internet & American Life Project, the same source we previously used to benchmark current adoption and the same source the Commission used to benchmark adoption for the National Broadband Plan. *See* Home Broadband 2013, http://pewinternet.org/Reports/2013/Broadband/Findings.aspx, accessed December 18, 2013. For estimating the percentage of rural Americans that have no access to broadband, we used the most recent report on US broadband availability by the National Telecommunications and Information Administration. In June 2012, 91.1% of rural Americans had access to broadband speeds greater than or equal to 3 Mbps/768 Mbps, which is roughly equivalent to the 4 Mbps/1 Mbps standard set by the Commission for CAF Phase II. 62% (rural penetration rate) divided by 91.1% (rural broadband access rate) = 68% (rural penetration rate in areas with broadband). *See US Broadband Availability: June 2010-June 2012*, NTIA, May 2013, at 10.

17 Nov. 13 *Ex Parte* at 3.

18 *See* Sept. 3 *Ex Parte* at 1.

19 *Id.*

threshold based on a fixed number of unserved locations to be served by the Alternative Technology Fund and then to extend the fund down to whatever lower threshold exhausts the $1.8 billion in annual funding.

ACA fails to see the basis for the argument that the FCC does not have data on ARPU. With ACA's filing from June 12, 2013,[20] and US Telecom's submission of rate survey data in the record, the FCC has sufficient data on ARPU upon which to base a revenue-based benchmark.

While the approach of setting the CAF Phase II based upon the size of the Alternative Technology Fund is indeed simpler, it is far more arbitrary and likely to result in an inefficient allocation of subsidies. It would require the Commission to engage in a subjective line drawing exercise in the most rural areas where the Commission would determine where support would be allocated to households based on a broadband service deployment via wireline and others via satellite. Relying on this arbitrary determination and the total amount of money set aside for price cap LECs under CAF II, the Commisssion would then allocate support to as many households as possible irrespective of the revenue that the location would generate for the carrier. As ACA has argued, the best way to ensure subsidies go to the right providers for the right locations is to follow the same methodology that providers use when planning real-world network investments[21]: subsidize only those locations where costs plus a desired rate of return exceed the expected revenue they will generate. That is, employ a revenue-based benchmark using the type of data and assumptions that ACA and US Telecom have provided in a series of filings.

Conclusion

In sum, ACA submits that there are a number of methodological flaws in US Telecom's rationale that cast doubt on its recommendations of a lower support threshold range of $40.83 to $54.83. Based on its research and analysis, ACA has recommended a lower support threshold of $64,[22] and it continues to advocate its adoption.

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20 *See* ACA *Ex Parte* at 9.

21 *Id.* at 3-4.

22 *Id.* at 10.

Sincerely,

Thomas Cohen

Thomas Cohen
Kelley Drye & Warren, LLP
3050 K Street N.W.
Washington, DC 20007
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