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

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| In the Matter of | ) | |
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| Connect America Fund | ) | WC Docket No. 10-90 |
| | ) | |
| High-Cost Universal Service Support | ) | WC Docket No. 05-337 |

**OPPOSITION OF THE UNITED STATES TELECOM ASSOCIATION TO APPLICATION FOR REVIEW**

The United States Telecom Association ("USTelecom")[1] respectfully submits its opposition to the Application for Review submitted by the American Cable Association ("ACA")[2] of the Wireline Competition Bureau's ("Bureau") April 22, 2014, decision in the Connect America Cost Model Report and Order ("*Cost Model Order*").[3] The Bureau, pursuant to delegated authority, finalized decisions regarding the engineering assumptions contained in the Connect America Cost Model ("CAM") and adopted inputs necessary for the model to calculate the cost of serving census blocks in price cap carrier areas.[4]

ACA presents no evidence that was not already considered in the Bureau's proceedings resulting in the *Cost Model Order* in which ACA admittedly "participated extensively."[5] It repeats the same policy arguments that were considered by the Bureau in reaching a reasonable

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[1]USTelecom is the premier trade association representing service providers and suppliers for the telecom industry. Its diverse member base ranges from large publicly traded communications corporations to small companies and cooperatives – all providing advanced communications service to both urban and rural markets.
[2] Application for Review of the American Cable Association, *In the Matter of Connect America Fund, High-Cost Universal Service Support* (WC Docket No. 10-90) (WC Docket No. 05-337), filed June 20, 2014) ("*ACA Application for Review*").
[3] *Connect America Fund*, WC Docket No. 10-90, *High-Cost Universal Service Support*, WC Docket No. 05-337, Report and Order, (Wireline Competition Bur., rel. Apr. 22, 2014) (*"Connect America Cost Model Report and Order" or "Cost Model Order"*).
[4] *Id* at ¶ 2.
[5] *See ACA Application for Review* at p. 1.

decision after a lengthy and extraordinarily open process. ACA presents no reason to alter the conclusions reached in the *Cost Model Order*; therefore the Commission should deny ACA's Application for Review.

## I. IF ANYTHING, THE COST OF CAPITAL USED IN THE CAM IS TOO LOW

USTelecom stands by its cost of capital calculation which resulted in a zone of reasonableness above 8.48% and below 9.52%, resulting in a point estimate of 9.00% with a weighted average approach debt-to-equity ratio of 33% debt to 67% equity and a cost of debt of 5.6%.[6] USTelecom will not repeat its voluminous analysis here, but notes that ACA presents no new information to contradict it. Yet ACA rejects the Bureau's considered conclusion which adopted a cost of capital 50 basis points below the recommendation of the ABC Coalition.

ACA complains that the predictions of "market observers" have been wrong as to a rise in interest rates from their historic lows and then draws two incorrect conclusions – first, that since a rise has not occurred recently it will not occur in the future, and second, that its expertise outweighs that of market observers and so it can confidently predict that rates will remain low for an extended period of time. It presents no data to justify either conclusion. As we are frequently cautioned, past performance of markets is not necessarily an indicator of future returns. Yet ACA substitutes its expertise for that of the economic analysis of the Commission and assures us that for the next five years, there is little basis to assume that interest rates will increase.

Further, publicly traded companies are constantly issuing new debt and refinancing old debt. Their cost of capital cannot be measured on their most recent debt issuance. So ACA's

[6] *See* USTelecom *Ex Parte* response to the new questions posed in the Virtual Workshop on May 17, 2013 (filed June 20, 2013), select portions of the May 16, 2013, Staff Report and certain statements previously made by the American Cable Association in its May 2, 2103 *Ex Parte* communication on this topic.

assertion that "price cap LECs have the ability to lock-in these low rates for the five year duration of Phase II in advance of any increase" is disingenuous. Companies may still possess outstanding debt today that is well above current and even future market rates, and may still have this debt for the next five years or more. This debt must be factored into their financial structure as well.

Also, debt is generally issued for general corporate purposes and is not associated with a particular project or program. So it is incorrect to conflate the 5-year term of support associated with the statewide election for cost model-based support with debt issued prior or during that period. Such debt may be used to refinance prior obligations or for investments other than those included in a provider's broadband buildout obligation.

Moreover, ACA's reliance on the Bureau's cost of capital analysis assumption of a support term of five years is incorrect for three reasons. First, if a price cap carrier accepts CAF II funding, then that carrier becomes obligated to provide broadband in areas that were previously deemed unprofitable by the carrier. The capital costs associated with meeting that obligation extend far beyond the 5-year funding period. Second, the Further Notice of Proposed Rulemaking ("*Notice*") suggests that the broadband speed requirement associated with CAF Phase II support be increased from 4 Mbps to 10 Mbps and requests comment on whether that increased obligation should be accompanied by an increase in the term of CAF II support.[7] The *Notice* suggests adding two years to the current five years of support and USTelecom proposes

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[7] *See In the Matter of Connect America Fund* (WC Docket No. 10-90), *Universal Service Reform – Mobility Fund* (WT Docket No. 10-208), *ETC Annual Reports and Certifications* (WC Docket No. 14-58), *Establishing Just and Reasonable Rates for Local Exchange Carriers* (WC Docket No. 07-135), *Developing an Unified Intercarrier Compensation Regime* (CC Docket No. 01-92), Report and Order, Declaratory Ruling, Order ("Order"), Memorandum Opinion and Order, Seventh Order on Reconsideration, and Further Notice of Proposed Rulemaking ("*Notice*") (rel. June 10, 2014) at ¶¶ 138 and 148.

that the appropriate term be ten years. Regardless of which option is selected, or if the Commission settles on a term for support of between 7 and 10 years, the result will be a term substantially longer than the 5 years included in the CAM adopted by the Bureau. Third, the recently adopted *Order* includes a term of support of ten years for winners of competitive bids in areas in which the price cap carrier has not accepted the statewide offer of support.[8] The *Notice* proposes basing the reserve price on the CAM, which, again, assumes a 5-year term. The cost of capital derived from the CAM with a 5-year term assumption that sets the reserve price may be considerably lower than a cost of capital based on a 10-year term. One wonders if members of ACA interested in participating in the competitive bidding process have taken that fact into consideration.

## II. THE CAM ADOPTED THE APPROPRIATE TAKE RATE

The Bureau adopted the appropriate take rate of 70% for use in the CAM. ACA conflates the current national broadband take rate of 70% with the rural take rate and offers the generality that "home broadband adoption is expected to grow."[9] This analysis suffers from three flaws. First, it is not clear that ACA has taken into account the fact that the locations in the model include vacant housing units and the estimates of take rate that are generally provided are relative to "households" – defined as an occupied housing unit. Thus, any external reference to take rates has to be lowered to account for vacancy rates which vary over time but are about 10 percent. Second, the rural populations located in areas eligible for CAF Phase II support tend to be poorer, older and less educated than the general population.[10] Each of these demographic

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[8] *Id* at ¶ 227.
[9] *See ACA Application for Review* at p. 7.
[10] *See* U.S. Department of Agriculture, Economic Research Service "Atlas of Rural and Small Town America" http://www.ers.usda.gov/data-products/atlas-of-rural-and-small-town-america.aspx (last visited July 2, 2014).

realities is consistent with lower rates of broadband adoption.[11] Third, ACA ignores the academic studies cited in the Order that suggest broadband subscription rates of 65 or 67 percent in the United States generally and estimated rural subscription rates as low as 50 percent.[12] According to a survey completed in September 2013, rural broadband adoption rates are at 60 percent, 10 percent to 14 percent lower than those in urban and suburban areas.[13] Even if broadband adoption does grow in these areas suffering from the demographic characteristics noted above that generally discourage purchase of broadband service, ACA includes no data as to the rate of that growth and whether or when it would meet or exceed the Order's 70 percent threshold.

ACA also assumes that customer service and general and administrative expenses are fully variable and directly proportional to the number of locations in which customers take service, as opposed to the number of locations connected. This is not the case. The CAM model derives its customer service and marketing operations expense from ARMIS data and ABC Coalition data, which were then evaluated as a percentage of total operating revenue. The CAM averaged these percentages and applied them to the assumed ARPU of the CAM services to derive customer service and marketing expense on the basis of total locations passed.[14] Nor are the general and administrative (G&A) expenses in the model assigned based on the number of locations that take service. The CAM derives its G&A expenses from regression analyses of

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[11] *See* Pew Research Internet Project "Broadband Technology Fact Sheet" http://www.pewinternet.org/fact-sheets/broadband-technology-fact-sheet/ (last visited July 2, 2014).

[12] *See Cost Model Order* at ¶ 179.

[13] *See* Pew Research Internet Project "Broadband Technology Fact Sheet" http://www.pewinternet.org/fact-sheets/broadband-technology-fact-sheet/ (last visited July 2, 2014).

[14] DOC-326423A1 Connect America Cost Model Methodology (Revised Apr. 2, 2014) at 30.

NECA data and assigns these expenses based on company size and density.[15] Therefore ACA is incorrect that the use of an 80 percent customer drop rate overstates cost in the CAM.

Finally, ACA implies that the Bureau did not consider the cost model's treatment of amortization of capital expenditures for drops, network interface devices, and customer premise equipment from the beginning of the support period, instead of when customers subscribe to the service. The Bureau directly addressed this issue by concluding that 80 percent is a reasonable estimate for the percentage of locations connected with a drop and optical network terminal. Its stated reason for adopting that number is that "an efficient provider will not physically connect every location when it runs fiber down a rural road, but rather will do so only when the subscriber chooses to subscribe."[16]

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[15] *Ibid.*
[16] *See Cost Model Order* at ¶ 82.

## III. CONCLUSION

ACA offers nothing new with respect to arguments or data that justify altering the conclusions reach in the *Cost Model Order*. The Commission should therefore deny ACA's Petition for Review.

Respectfully submitted,

UNITED STATES TELECOM ASSOCIATION

By: ______________________________

David Cohen
Jonathan Banks

Its Attorneys

607 14th Street, NW
Suite 400
Washington, D.C. 20005

July 7, 2014

**Service List**

I, Kevin G. Rupy, do hereby certify that I have caused the foregoing Opposition of the United States Telecom Association to Application for Review to be served via First Class United States mail, postage prepaid, on the parties listed on the following service list.

Kevin G. Rupy

July 7, 2014

| | |
|---|---|
| Cathy Carpino<br>Gary L. Phillips<br>Peggy Garber<br>AT&T Services, Inc.<br>1120 20th Street, N.W., Suite 1000<br>Washington, D.C. 20036 | Leonard A Steinberg<br>Richard R. Cameron<br>Alaska Communications Systems Group, Inc.<br>600 Telephone Avenue<br>Anchorage, AK 99503 |
| Genevieve Morelli<br>Micah M. Caldwell<br>ITTA<br>1101 Vermont Avenue, N.W.,<br>Suite 501<br>Washington, D.C. 20005 | Frank R. Lindh<br>Helen M. Mickiewicz<br>Kimberly J. Lippi<br>California Public Utilities Commission<br>505 Van Ness Avenue<br>San Francisco, CA 94102 |
| Richard A. Askoff<br>NECA<br>80 South Jefferson Road<br>Whippany, NJ 07981 | Derrick Owens<br>Vice President of Government Affairs<br>Western Telecommunications Alliance<br>317 Massachusetts Avenue N.E.<br>Suite 300C<br>Washington, D.C. 20002 |
| Stephen L. Goodman<br>Butzel Long Tighe Patton, PLLC<br>1747 Pennsylvania Ave, N.W., Suite 300<br>Washington, D.C. 20006<br>*Counsel for ADTRAN, Inc.* | Michael F. Altschul<br>Christopher Guttman-McCabe<br>Scott K. Bergmann<br>CTIA -The Wireless Association®<br>1400 16th Street, N W, Suite 600<br>Washington, D.C. 20036 |

| | |
|---|---|
| Brian Ford<br>Regulatory Counsel<br>NTCA<br>4121 Wilson Boulevard, 10th Floor<br>Arlington, VA 22203 | Steven F. Morris<br>Jennifer K. McKee<br>National Cable & Telecommunications Association<br>25 Massachusetts Avenue, NW, Suite 100<br>Washington, D.C. 20001-1431 |
| Jerry Weikle<br>Regulatory Consultant<br>Eastern Rural Telecom Assn.<br>5910 Clyde Rhyne Drive<br>Sanford, NC 27330 | Gerard J. Duffy<br>Blooston, Mordkofsky, Dickens, Duffy<br>& Prendergast, LLP<br>2120 L Street, N.W., Suite 300<br>Washington, D.C. 20037<br>Regulatory Counsel for WTA |
| Stephen E. Coran<br>F. Scott Pippin<br>Lerman Senter PLLC<br>2000 K Street, N.W., Suite 600<br>Washington, D.C. 20006-1809<br>*Counsel to the Wireless Internet Service Providers Association* | John T. Nakahata<br>Wiltshire & Grannis LLP<br>1200 Eighteenth Street, N.W.<br>Washington, D.C. 20036<br>Counsel for General Communication, Inc. |
| Alexicon Telecommunications Consulting<br>3210 E. Woodmen Road, Suite 210<br>Colorado Springs, CO 80920 | Tina Pidgeon<br>Chris Nierman<br>General Communications, Inc.<br>1350 I Street, N.W., Suite 1260<br>Washington, D.C. 20005 |
| Joseph K. Witmer<br>Pennsylvania Public Utilities Commission<br>Commonwealth Keystone Building<br>400 North Street<br>Harrisburg, PA 17120 | Paul F. Guarisco<br>W. Bradley Kline<br>Phelps Dunbar<br>400 Convention Street, Suite 1100<br>PO Box 4412<br>Baton Rouge, LA 70821-4412<br>*Counsel for the Small Company Committee of the Louisiana Telecommunications Association* |
| Karen Brinkman<br>Karen Brinkmann PLLC<br>2300 N Street, N. W., Suite 700<br>Washington, D.C. 20037<br>*Counsel to Alaska Communications Systems* | Jeffery H. Smith<br>Kenneth T. Burchett<br>GVNW Consulting, Inc.<br>8050 S.W. Warm Springs Street, Suite 200<br>Tualatin, OR 97062 |

| | |
|---|---|
| Mike George<br>Louisiana Telecommunications Association<br>7266 Tom Drive, Suite 205<br>Baton Rouge, LA 70821 | Janet S. Boles<br>The Boles Law Firm<br>7914 Wrenwood Boulevard, Suite A<br>Baton Rouge, LA 70809<br>*Counsel for the Small Company Committee of the Louisiana Telecommunications Association* |
| David A. LaFuria<br>John Cimko<br>Lukas, Nace, Gutierrez & Sachs LLP<br>8300 Greensboro Drive, Suite 1200<br>McLean, VA 22102<br>*Counsel to United States Cellular Corporation, Union Wireless* | John P. Janka<br>Jarett S. Taubman<br>Latham & Watkins LLP<br>555 Eleventh Street, N.W., Suite 1000<br>Washington, D.C. 20004<br>*Counsel to ViaSat, Inc.* |
| Grant B. Spellmeyer<br>United States Cellular Corporation<br>8410 West Bryn Mawr<br>Chicago, IL 60631 | Marlena F. Barzilai<br>Eric N. Einhorn<br>Windstream Corporation<br>1101 17$^{th}$ Street, N.W., Suite 802<br>Washington, D.C. 20036 |
| John Kuykendall<br>Vice President<br>John Staurulakis, Inc.<br>7825 Walker Drive, Suite 200<br>Greenbelt, MD 20770 | Shannon M. Heim<br>Elizabeth Gray Nunez<br>50 S. Sixth Street, Suite 1500<br>Minneapolis, MD 55402 |
| David DengeJ CEO/General Manager<br>Copper Valley Telecom<br>PO Box 337<br>Valdez, AK 99686 | Christopher M. Miller<br>David L. Haga<br>1320 North Courthouse Road<br>9$^{th}$ Floor<br>Arlington, VA 22201<br>*Attorneys for Verizon Wireless* |
| James Rowe<br>Executive Directory<br>Alaska Telephone Association<br>201 E. 56$^{th}$ Street, Suite 114<br>Anchorage, AK 99518 | John Charles Padalino<br>Administrator, Rural Utilities Service<br>USDA<br>1400 Independence Ave. SW<br>Washington, DC 20250 |

| | |
|---|---|
| Susan Case<br>RTI Pend Oreille Telecom<br>892 W. Madison Avenue<br>Glenns Ferry, ID 83623 | James E. Dunstan<br>Mobius Legal Group, PLLC<br>PO Box 6104<br>Springfield, VA 22150<br>*Counsel to NNTRC* |
| Brian Tagaban<br>Executive Director<br>Navajo Nation Telecommunications<br>Regulatory Commission<br>PO Box 7740<br>Window Rock, AZ 86515 | Lawrence Zawalick<br>Senior Vice President<br>Rural Telephone Finance Cooperative<br>20701 Cooperative Way<br>Dulles, VA 20116 |
| Kandis Martine<br>Navajo Dept. of Justice<br>PO Box 2010<br>Window Rock, AZ 86515<br>*Counsel to NNTRC* | Gerard Duffy<br>Blooston, Mordkofsky, Dickens,<br>Duffy & Pendergast , LLP<br>2120 L Street NW, Suite 300<br>Washington, DC 20037<br>*Counsel for Western Telecom Alliance* |
| Helen M. Mickiewicz<br>505 Van Ness Avenue<br>San Francisco, CA 94102<br>*Attorneys for the California PUC*<br>*and the People of the State of California* | Kate Creswell<br>Idaho Telecom Alliance<br>PO Box 1638<br>Boise, ID 83701 |
| David Cosson<br>Rural Independent Competitive Alliance<br>5151 Wisconsin Ave, NW<br>Washington, DC 20016 | Jacqueline Pata<br>Executive Director<br>National Congress of American Indians<br>1516 P Street N W<br>Washington, DC 20005 |
| Thomas Cohen<br>Joshua Guyan<br>Kelley Drye & Warren LLP<br>3050 K Street, NW<br>Suite 400<br>Washington, DC 20007<br>*Counsel to the*<br>*American Cable Association* | Matthew M. Polka<br>President and Chief Executive Officer<br>American Cable Association<br>One Parkway Center<br>Suite 212<br>Pittsburgh, Pennsylvania 15220 |

| | |
|---|---|
| Ross J. Lieberman<br>Senior Vice President of Government Affairs<br>American Cable Association<br>2415 39th Place, NW<br>Washington, DC 20007 | |