Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D. C. 20554

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

RESPONSE TO OPPOSITION TO APPLICATION FOR REVIEW OF THE AMERICAN CABLE ASSOCIATION

On June 20, 2014, the American Cable Association ("ACA") filed an Application for Review[1] requesting that the Commission amend two key aspects of the *Connect America Cost Model Report and Order* adopted by the Wireline Competition Bureau ("Bureau").[2] ACA explained that: (1) the Bureau adopted a cost of money that is significantly in excess of forward-looking market rates; and, (2) the "take-rate" factor used in establishing the funding benchmark is well below that expected over the long-run life of the Connect America Cost Model ("CAM") – and even below that expected over the five-year funding period. Taken together, ACA submitted these errors result in the provision of support to the price cap LECs in excess of the amount required, and it provided the Commission with specific fixes for these problems. In

1 Application for Review of the American Cable Association, *In the Matter of Connect America Fund*, WC Docket No. 10-90, *High-Cost Universal Service Support*, WC Docket No. 05-337 (filed June 20, 2014) ("*AFR*").

2 *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 "*Order*").

response to ACA's filing, on July 7, 2014, the United States Telecom Association ("USTelecom") filed an *Opposition*[3] to which ACA hereby responds.

<u>Response to *Opposition* on the Issue of the Cost of Capital</u>

USTelecom critiques ACA's arguments for lowering the cost of capital based largely on the notion that price cap local exchange carriers' ("LECs'") current debt costs do not accurately reflect the debt costs recipients of Connect America Fund ("CAF") Phase II support will actually incur. First, USTelecom argues that ACA disregards the possibility of future interest rate hikes.[4] However, in the *AFR*, ACA accounted for this concern by including a "stress test" which envisioned a 100-point rise in 10-year Treasury bond yields. Even under this "stress test" scenario, the cost of capital still falls below the Bureau's adopted standard of 8.5 percent.[5]

Second, USTelecom asserts that the cost of capital for CAF Phase II build-outs cannot be calculated based on price cap LECs' most recent debt issuance and should rather be based on their company-wide debt costs.[6] This argument is flawed on a number of grounds.

As the Bureau noted in the *Connect America Cost Model Report and Order*, the cost of capital for CAF Phase II "will effectively be locked in for the next five years."[7] Whether or not price cap LECs issue debt for general corporate purposes or for specific projects is immaterial; price cap LECs clearly have the option to issue debt specifically for CAF Phase II build-outs, the cost of which both the Bureau and ACA attempted to estimate. It is not the Bureau's responsibility to compensate price cap LECs for past debt issuances that carried high interest

---

3 Opposition of the United States Telecom Association to Application for Review, *In the Matter of Connect America Fund*, WC Docket No. 10-90, *High-Cost Universal Service Support*, WC Docket No. 05-337 (filed July 7, 2014) ("*Opposition*").

4 *Id.* at 2.

5 *AFR* at 5.

6 *Opposition* at 2-3.

7 *Connect America Cost Model Report and Order*, ¶ 107.

rates due either to project risk or market perceptions of a company's credit-worthiness. On the reverse side, if, as USTelecom asserts, price cap LECs should be compensated for debt for general corporate obligations, then those with large wireless businesses should be compensated on an even lower cost of capital, as Verizon and AT&T benefit from low rates for their highly profitable wireless businesses. In any case, as detailed in the *AFR*,[8] the market for corporate debt is currently quite friendly for borrowers, and there is ample opportunity for large stable businesses to refinance older debt at more favorable rates.

Additionally, USTelecom continually critiques ACA for assuming a five-year term for funding for broadband build-outs, but the source of its critique is not clear. ACA based its cost of capital calculation on 10-year Treasury yields and yields to maturity of corporate bonds that mature in 2024.[9] ACA submits that a 10-year term adequately reflects the investment horizon typical for a network build-out.

For the foregoing reasons, the Commission should reject the critique of USTelecom and adopt ACA's proposal to select the mid-point of the range of the cost money for the price cap LECs – 7.72 percent.

<u>Response to *Opposition* on the Issue of the Take Rate</u>

USTelecom dismisses ACA's argument that the take rate should be higher than 70 percent primarily by arguing that rural take rates are lower than urban take rates because rural populations "tend to be poorer, older and less educated that the general population."[10] However, as the *AFR* demonstrates, other evidence supports a much different conclusion.

---

8 *AFR* at 4-5.

9 *Id.* at 5, n. 14.

10 *Opposition* at 4.

As ACA explained in the *AFR*, the take-rate in rural areas is fundamentally restrained by availability.[11] According to the Pew Center's latest data (September 2013), 60 percent of rural adults subscribe to home broadband,[12] while wireline broadband is only available to 77.3 percent of the rural population.[13] Using availability as the denominator, 77.6 percent of rural adults with access to broadband are subscribers today. This is the basis upon which the Bureau should calculate the take rate. Further, in the face of the Pew Center's data, there is no reasoned basis for USTelecom to argue in support of,[14] and the Bureau to rely on,[15] a four-year-old data point referenced by Professor Hogendorn that only 50 percent of rural Americans have adopted broadband.[16]

USTelecom also dismisses ACA's assertion that "home broadband adoption is expected to grow" as a "generality."[17] This position, however, ignores the data from the Pew Center that shows broadband adoption has steadily grown since it first started collecting survey data on broadband usage in 2000.[18]

---

11 *AFR* at 7-8.

12 *See* "Broadband Technology Fact Sheet," Pew Research Internet Project, (September 2013), available at: http://www.pewinternet.org/fact-sheets/broadband-technology-fact-sheet/ (Accessed July 10, 2014) ("Pew Research Internet Project").

13 *See* "Broadband Statistics Report: Broadband Availability in Urban vs. Rural Areas," National Telecommunications and Information Administration, at 10 (2013), available at: http://www.broadbandmap.gov/download/Broadband%20Availability%20in%20Rural%20vs%20Urban%20Areas.pdf. (Accessed July 10, 2014).

14 *Opposition* at 5.

15 *Connect America Cost Model Report and Order*, ¶ 179.

16 *See* Richard Bennett, Luke A. Stewart and Robert D. Atkinson, The Whole Picture: Where America's Broadband Networks Really Stand, ITIF: The Information Technology & Innovation Foundation, at 26 (2013), available at: http://www2.itif.org/2013-whole-picture-america-broadband-networks.pdf. (Accessed July 10, 2014).

17 *Opposition* at 4.

18 *See* Pew Research Internet Project.

Additionally, USTelecom critiques ACA for arguing that using a higher take rate overcompensates CAF Phase II recipients for operating expenditures because these expenses are generally variable on a per-customer basis. USTelecom is correct that the CAM does not model customer-related operating expenses (General & Administrative and Customer Operations Marketing & Service) on a per-customer basis. But that is a flaw with the model, not ACA's reasoning. It is not clear why customer-related expenses should be modeled on a per-company basis (as G&A is) or on a per-passed-location basis (as Customer Operations Marketing & Service is).[19] This suggests the model would produce the same G&A and Customer Operations Marketing & Service expenditures whether the take rate is 100 percent--or 10 percent! This does not reflect reality, where lower customer counts are typically associated with lower headcount and lower expenses.[20] Using an artificially high take rate only distorts this mismatch between the model's output and real-world operator behavior further.

Finally, USTelecom seeks to dismiss ACA's point about how the model overcompensates CAF Phase II recipients for drops, network interface devices and customer premise equipment,[21] but it offers no evidence to support its point. Instead, it points to a quote from the *Order*—"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"[22]—that in fact reinforces rather than undermines ACA's argument. Because efficient providers only connect locations

---

19 *See* DOC-326423A1 Connect America Cost Model Methodology (Revised Apr. 2, 2014) at 30.

20 For example, Frontier Communications reduced its non-network operating expenses 4 percent from 2012 to 2013, when it lost 3 percent of total customers. It reduced its non-network operating expenses 2 percent from 2011 to 2012, when it lost 7 percent of total customers. Frontier Communications Form 10-K, filed Feb. 27, 2014, available at http://files.shareholder.com/downloads/AMDA-OJWDG/3328441085x0xS20520-14-17/20520/filing.pdf. (Accessed July 15, 2014).

21 *Opposition* at 6.

22 *Id.*

when customers subscribe, providers will be over-compensated because the model begins funding providers for the cost of connection as if all future subscribers were connected from day one. Those dollars received today are worth more than they would be in the future due to the declining time value of money.

Accordingly, the 70 percent take rate adopted by the Bureau is clearly too low and does not accurately reflect the expected take-rate during the time CAF support would be awarded to price cap LECs.

Respectfully submitted,

Thomas Cohen

Matthew M. Polka President and Chief Executive Officer American Cable Association One Parkway Center Suite 212 Pittsburgh, Pennsylvania 15220 (412) 922-8300 Ross J. Lieberman Senior Vice President of Government Affairs American Cable Association 2415 39th Place, NW Washington, DC 20007 (202) 494-5661 July 17, 2014	Thomas Cohen Joshua Guyan Kelley Drye & Warren LLP 3050 K Street, NW Suite 400 Washington, DC 20007 Tel. (202) 342-8518 Fax (202) 342-8451 tcohen@kelleydrye.com Counsel to the American Cable Association

CERTIFICATE OF SERVICE

I, Dawn Damschen, do hereby certify that I have caused the foregoing Application for Review of the American Cable Association to be served via First Class United States mail, postage prepaid, on the parties listed on the attached service list.

Dawn Damschen

Dawn Damschen

July 17, 2014

Service List

Cathy Carpino
Gary L. Phillips
Peggy Garber
AT&T Services, Inc.
1120 20th Street, N.W., Suite 1000
Washington, D.C. 20036

Leonard A Steinberg
Richard R. Cameron
Alaska Communications Systems
Group, Inc.
600 Telephone Avenue
Anchorage, AK 99503

Genevieve Morelli
Micah M. Caldwell
ITTA
1101 Vermont Avenue, N.W., Suite 501
Washington, D.C. 20005

Frank R. Lindh
Helen M. Mickiewicz
Kimberly J. Lippi
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Richard A. Askoff
NECA
80 South Jefferson Road
Whippany, NJ 07981

Derrick Owens
Vice President of Government Affairs
Western Telecommunications Alliance
317 Massachusetts Avenue N.E.
Suite 300C
Washington, D.C. 20002

Stephen L. Goodman
Butzel Long Tighe Patton, PLLC
1747 Pennsylvania Ave, N.W., Suite 300
Washington, D.C. 20006
Counsel for ADTRAN, Inc.

Michael F. Altschul
Christopher Guttman-McCabe
Scott K. Bergmann
CTIA — The Wireless Association®
1400 16th Street, NW, Suite 600
Washington, D.C. 20036

Brian Ford
Regulatory Counsel
NTCA
4121 Wilson Boulevard, 10th Floor
Arlington, VA 22203

Steven F. Morris
Jennifer K. McKee
National Cable & Telecommunications
Association
25 Massachusetts Avenue, NW, Suite 100
Washington, D.C. 20001-1431

Jerry Weikle
Regulatory Consultant
Eastern Rural Telecom Assn.
5910 Clyde Rhyne Drive
Sanford, NC 27330

David Cohen
Jonathan Banks
United States Telecom Association
607 14th Street, N.W., Suite 400
Washington, D.C. 20005

Gerard J. Duffy
Blooston, Mordkofsky, Dickens, Duffy
& Prendergast, LLP
2120 L Street, N.W., Suite 300
Washington, D.C. 20037
Regulatory Counsel for WTA

Stephen E. Coran
F. Scott Pippin
Lerman Senter PLLC
2000 K Street, N.W., Suite 600
Washington, D.C. 20006-1809
Counsel to the Wireless Internet Service Providers Association

John T. Nakahata
Wiltshire & Grannis LLP
1200 Eighteenth Street, N.W.
Washington, D.C. 20036
Counsel for General Communication, Inc.

Alexicon Telecommunications Consulting
3210 E. Woodmen Road, Suite 210
Colorado Springs, CO 80920

Tina Pidgeon
Chris Nierman
General Communications, Inc.
1350 I Street, N.W., Suite 1260
Washington, D.C. 20005

Joseph K. Witmer
Pennsylvania Public Utilities Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Paul F. Guarisco
W. Bradley Kline
Phelps Dunbar
400 Convention Street, Suite 1100
PO Box 4412
Baton Rouge, LA 70821-4412
Counsel for the Small Company Committee of the Louisiana Telecommunications Association

Karen Brinkmann
Karen Brinkmann PLLC
2300 N Street, N.W., Suite 700
Washington, D.C. 20037
Counsel to Alaska Communications Systems

Jeffery H. Smith
Kenneth T. Burchett
GVNW Consulting, Inc.
8050 S.W. Warm Springs Street
Suite 200
Tualatin, OR 97062

Mike George
Louisiana Telecommunications
Association
7266 Tom Drive, Suite 205
Baton Rouge, LA 70821

Janet S. Boles
The Boles Law Firm
7914 Wrenwood Boulevard, Suite A
Baton Rouge, LA 70809
Counsel for the Small Company Committee of the Louisiana Telecommunications Association

David A. LaFuria
John Cimko
Lukas, Nace, Gutierrez & Sachs LLP
8300 Greensboro Drive, Suite 1200
McLean, VA 22102
Counsel to United States Cellular Corporation, Union Wireless

John P. Janka
Jarett S. Taubman
Latham & Watkins LLP
555 Eleventh Street, N.W., Suite 1000
Washington, D.C. 20004
Counsel to ViaSat, Inc.

Grant B. Spellmeyer
United States Cellular Corporation
8410 West Bryn Mawr
Chicago, IL 60631

Marlena F. Barzilai
Eric N. Einhorn
Windstream Corporation
1101 17th Street, N.W., Suite 802
Washington, D.C. 20036

John Kuykendall
Vice President
John Staurulakis, Inc.
7825 Walker Drive, Suite 200
Greenbelt, MD 20770

Shannon M. Heim
4000 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
Counsel to the Alaska Rural Coalition

David Dengel
CEO/General Manager
Copper Valley Telecom
PO Box 337
Valdez, AK 99686

Christopher M. Miller
David L. Haga
1320 North Courthouse Road
9th Floor
Arlington, VA 22201
Attorneys for Verizon Wireless

James Rowe
Executive Directory
Alaska Telephone Association
201 E. 56th Street, Suite 114
Anchorage, AK 99518

John Charles Padalino
Administrator, Rural Utilities Service
USDA
1400 Independence Ave. SW
Washington, DC 20250

Susan Case
RTI Pend Oreille Telecom
892 W. Madison Avenue
Glenns Ferry, ID 83623

James E. Dunstan
Mobius Legal Group, PLLC
PO Box 6104
Springfield, VA 22150
Counsel to NNTRC

Brian Tagaban
Executive Director
Navajo Nation Telecommunications
Regulatory Commission
PO Box 7740
Window Rock, AZ 86515

Kandis Martine
Navajo Dept. of Justice
PO Box 2010
Window Rock, AZ 86515
Counsel to NNTRC

Helen M. Mickiewicz
505 Van Ness Avenue
San Francisco, CA 94102
Attorneys for the California PUC
and the People of the State of California

David Cosson
Rural Independent Competitive Alliance
5151 Wisconsin Ave NW
Washington, DC 20016

Lawrence Zawalick
Senior Vice President
Rural Telephone Finance Cooperative
20701 Cooperative Way
Dulles, VA 20116

Gerard Duffy
Blooston, Mordkofsky, Dickens,
Duffy & Pendergast, LLP
2120 L Street NW, Suite 300
Washington, DC 20037
Counsel for Western Telecom Allicance

Kate Creswell
Idaho Telecom Alliance
PO Box 1638
Boise, ID 83701

Jacqueline Pata
Executive Director
National Congress of American Indians
1516 P Street NW
Washington, DC 20005