Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92

REPLY COMMENTS
of the
NATIONAL EXCHANGE CARRIER ASSOCIATION, Inc.; NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION; ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES; and WESTERN TELECOMMUNICATIONS ALLIANCE;

CONCURRING ASSOCIATIONS*

California Independent Telephone Companies
Colorado Telecommunications Association[2,3]
Idaho Telecom Alliance[3]
Illinois Independent Telephone Association[3]
INDATELgroup ™
Indiana Exchange Carriers Association
Iowa Telecommunications Association[2,4]
Kansas Fiber Network
Kansas Telecommunications Industry Association
Minnesota Independent Coalition[2]
Minnesota Telecom Alliance[2]
Montana Independent Telecommunications Systems
Montana Telecommunications Association[2]
New Hampshire Telephone Association[3]
Nevada Telecommunications Association[2]
North Dakota Association of Telecom Cooperatives
Oklahoma Telephone Association[1]
Oregon Telecommunications Association[2,4]
Rural Arkansas Telephone Systems
Rural Iowa Independent Telephone Association
Rural Telephone Management Council
South Dakota Telecommunications Association
State Independent Telephone Association of Kansas[3]
Telecommunications Association of Michigan[2]
Telecommunications Associations of the Southeast[2,5]
Telephone Association of Maine[3]
Telephone Association of New England[3]
Telephone Association of Vermont[3]
Tennessee Telecommunications Association
Washington Independent Telecommunications Association[2,3,4]
Wisconsin State Telecommunications Association
Wyoming Telecommunications Association[2]

*Concurrence by marked associations does not include the participation or concurrence of one or more member companies as identified by numeric code: (1 = AT&T, 2 = CenturyLink, 3 = FairPoint, 4 = Frontier, 5 = Windstream).

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I. INTRODUCTION AND SUMMARY

The Rural Associations'[1] initial comments in this proceeding supported the continued adaptation of existing Universal Service Fund ("USF") high-cost support mechanisms to an evolving broadband world, as well as reform of the Intercarrier Compensation ("ICC") system. The Rural Associations further applauded several specific steps proposed by the Federal Communications Commission (the "Commission") in connection with this reform, as well as the staged manner in which the Commission suggested it might approach and implement its reform initiatives.

However, the Rural Associations – together with numerous other commenters – also demonstrated substantial adverse impacts that would arise from certain specific proposals set forth in the Commission's Notice of Proposed Rulemaking ("NPRM").[2] They explained that if certain proposals in the NPRM are adopted, many rural rate-of-return incumbent local exchange carriers ("RLECs") will lose support essential for the operation and maintenance of their existing multiple-use networks. These companies will come under pressure to raise rates for residential

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[1] The National Exchange Carrier Association, Inc. (NECA) is responsible for preparation of interstate access tariffs and administration of related revenue pools, and collection of certain high-cost loop data. *See generally,* 47 C.F.R. §§ 69.600 *et seq.*; *MTS and WATS Market Structure*, CC Docket No.78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983). The National Telecommunications Cooperative Association (NTCA) is a national trade association representing more than 580 rural rate-of-return regulated telecommunications providers. The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) is a national trade association representing approximately 460 small incumbent local exchange carriers (ILECs) serving rural areas of the United States. The Western Telecommunications Alliance (WTA) is a trade association that represents over 250 small rural telecommunications companies operating in the 24 states west of the Mississippi River.

[2] *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 26 FCC Rcd 4554 (2011).

consumers and businesses where legally permissible and economically feasible, may lose the ability to repay existing loans, and could find it difficult or impossible to access additional capital needed for further broadband deployment. Instead of having access to "reasonably comparable" services at "reasonably comparable" rates, rural consumers will experience substantial declines in the quality, affordability and availability of services.

To avoid these results, the Rural Associations presented a comprehensive alternative plan (the "RLEC Plan") designed specifically to be consistent with the reform principles set out by the Commission, without disrupting service to rural consumers and businesses. The RLEC Plan has also been designed to fit in all respects within the strict legal parameters for universal service support set forth in sections 214 and 254 of the Communications Act, as amended (the "Act").

Comments filed by the industry and many state regulators, as well as the State Members of the Federal-State Joint Board on Universal Service ("State Members"), confirm the Rural Associations' concerns regarding the proposals set forth in the NPRM. Individual RLECs, their consultants and other commenters have demonstrated how proposed changes to USF and ICC rules will harm rural consumers and undermine existing broadband deployment and adoption rates. These comments underscore that the Commission should not put at risk the delicate balance that makes quality voice and broadband services available and affordable to wide swaths of rural America on a "bet" that novel, untested reforms *might* prompt the deployment of broadband in the outlying portions of larger carriers' serving areas.

The comments also make clear that certain proposed changes in existing high-cost support mechanisms are unlikely to produce a smooth path to a broadband-based system, but instead will likely lead to judicial challenges and enmesh the Commission and the industry in unending legal and implementation quagmires. For example, while it may seem desirable to

distribute support to entities other than eligible telecommunications carriers ("ETCs") for the provision of non-telecommunications services, or to permit providers to "self designate" support areas for purposes of reverse auctions, such proposals raise significant questions under existing law and are at significant risk of reversal or remand on appeal. Meanwhile, proposals to account somehow for "non-regulated" revenues in support calculations or to redraw study areas for purposes of isolating support to supposedly non-competitive areas will raise a host of legal issues and implementation burdens that far outweigh whatever benefits might be obtained.

With respect to ICC reform, there will be little or no incentive for some carriers to construct, operate and maintain expensive broadband networks if other carriers and service providers can make use of them at little or no cost. This is particularly true in rural areas where substantial customer rate increases would be needed to replace access and reciprocal compensation revenues. The Rural Associations agree that existing ICC rates need to be restructured to eliminate anomalies and arbitrage incentives. However, attempts to impose a mandatory bill-and-keep regime (or to prescribe extremely low rates such as $0.0007 that do not even cover the costs of billing and collection) will harm rural consumers, drastically undermine universal service, and face substantial legal challenge from state authorities and industry participants. For a Commission interested in "market-driven" reforms, it would be a far stretch indeed to impose arbitrary one-size-fits-all "price controls" on the rates that carriers may charge one another for use of their networks.

The RLEC Plan, in contrast, would achieve the reform objectives set out by the Commission in a practical manner, without running afoul of existing statutory constraints, introducing complications in implementation, or damaging the progress that RLECs have made deploying broadband in rural America. Specifically, the Plan promotes fiscal responsibility by

including reasonable constraints on prospective capital investment and corporate operations expense recovery. It assures accountability by encouraging the adoption of strict, but reasonable, "carrier-of-last-resort" ("COLR") obligations on fund recipients and retaining existing cost-accounting rules. And it modernizes today's support mechanisms by transitioning from legacy RLEC high-cost support mechanisms to an RLEC-specific component of the Connect America Fund ("CAF") that preserves the core tenets of a rate-of-return ("RoR") framework. As the comments show, RoR regulation, coupled with support based on actual costs, has proven strikingly effective and efficient in promoting substantial deployment of affordable, high-quality broadband service throughout RLEC areas in recent years. It would be foolhardy to abandon these methods for unproven approaches such as reverse auctions and/or cost models.

The RLEC Plan also calls for the Commission to work in cooperation with states to accomplish responsible ICC reform, a course that is much less likely to raise significant legal concerns. Recognizing the complex, interwoven nature of these initiatives, the RLEC Plan also incorporates sensible "pause points" to enable the Commission to take account of marketplace, technological and regulatory developments that should inform how further reforms are structured. This will permit reform to take place in market-driven stages rather than pursuant to large sweeping predictive judgments that may fail to consider fully (or be able to adjust for) all of the potential short-term and longer-term consequences.

In short, the Rural Associations wholeheartedly applaud the Commission's "end game" objective – furthering the ubiquitous availability of high-quality, affordable broadband to *all* Americans in as efficient and effective a manner as possible. But sometimes the shortest route between two points really is a straight line. Rather than betting America's broadband future on grand visions, untested schemes, and complicated, circuitous and legally questionable processes,

there is a clear and straightforward roadmap for what has worked – and what has failed – in promoting affordable broadband in rural America. The Commission needs to be concerned not just about making sure that broadband services *become* available in unserved areas, but that they *remain* affordable and high-quality once available – as carriers with decades of commitment to serving rural communities, RLECs can attest that deploying the network is only the first of a series of significant challenges to satisfying consumer demand. The Rural Associations acknowledge that the existing system needs improvement, and in fact, they welcome measures to improve its sustainability and effectiveness in a broadband-oriented marketplace. The Commission should not, however, "throw the baby out with the bathwater." Instead, with America's broadband future hanging in the balance, the Commission should retain what has worked in RLEC areas and build upon that success through carefully calibrated, surgical reform measures.

II. THE NEAR-TERM REFORM MEASURES PROPOSED UNDER THE RLEC PLAN WILL SUCCESSFULLY ADDRESS CONCERNS REGARDING RECOVERY OF CAPITAL EXPENDITURES AND OPERATIONAL EXPENSES THROUGH HIGH-COST SUPPORT, WITHOUT HARMING RURAL CONSUMERS.

The record in this proceeding demonstrates that the near-term USF and ICC reform proposals described in the NPRM, if adopted, would cause substantial harm to rural consumers in RLEC areas and seriously damage prospects for achievement of the Commission's broadband goals. Fortunately, there are other, more consumer-friendly ways to reform existing RLEC high-cost and ICC mechanisms that remain consistent with the Commission's reform principles, including specifically the limitations on recovery of capital expenditures and operational expenses proposed under the RLEC Plan.

A. The NPRM's Proposals to Revise Current RLEC High-Cost Support Mechanisms and Reduce ICC Rates to Below-Cost Levels Will Significantly Increase Rates for Rural Consumers and Put Many RLECs at Risk of Defaulting on Loans.

The Rural Associations showed in their comments that the combined effect of changing High Cost Loop Support ("HCLS") reimbursement percentages and eliminating support for corporate operations expenses as proposed in the NPRM would cause significant reductions in support for some companies.[3] While the average drop in revenue for all RLECs would be 5.2 percent, those in the top ten percent group would experience revenue losses of 15 percent or more.[4] This translates to potential local rate increases of $33.61 per line per month for the hardest hit areas (assuming that state commissions would approve such increases and that rural customers would be able and willing to pay them). These reductions would in any event cause almost half of all companies analyzed to fall below the Times Interest Earned Ratio ("TIER") used by RUS in its loan covenants.[5] When the revenue losses from reducing ICC to reciprocal compensation levels are added to these impacts, local rates would have to increase by *an additional* $25.89 or more per line for the hardest-hit areas, bringing the potential rate shock to over $59.50 for some study areas.[6]

Data provided by individual RLECs, consultants, state commissions and the State Members confirm that the NPRM's proposals would, in the absence of an alternative source of

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[3] NECA, NTCA, *et al.*'s Comments, WC Docket No. 10-90 (filed Apr. 18, 2011) at 40-42 (Rural Associations).

[4] *Id.* at 41.

[5] *Id.*, Appendix B.

[6] The Associations also showed that elimination of Local Switching Support ("LSS") (or combining it with HCLS) would require local rate increases of around $16.91 for the top 10 percent of companies or cause local switching rates to increase by 127 percent, with an overall increase in traffic sensitive switched access charges of about 80 percent. RLECs receiving Safety Net Additive ("SNA") support would lose an average of $3.34 per line per month if SNA were eliminated. *Id.* at 42.

support, lead to substantial local rate increases, reduce RLECs' access to capital, and in many cases put providers on the precipice of default with respect to existing loans. There has been an avalanche of filings by RLECs from across the country demonstrating that the proposals to modify RLEC high-cost support mechanisms outlined in the NPRM, combined with proposals to reduce switched access rates to substantially lower levels, would in the absence of alternative support mechanisms create the need for RLECs to increase end-user rates dramatically to recover lost revenues. Rate increases identified in such comments range from $12.94 to $98.32 per line per month.[7] For example, the following companies indicated they would need to raise local rates:

- Rural Telephone (Idaho) by as much as $87.12, an increase of more than 338.19 percent, bringing the average rate for basic local service to a staggering $112.88 per month, not including the Federal Subscriber Line Charge ("SLC"), calling features, and taxes and surcharges;[8]

- Ducor (California) by as much as $65.05, an increase of more than 321.23 percent, bringing the average rate for basic local service to a staggering $85.30 per month, not including the Federal SLC, calling features, and taxes and surcharges;[9]

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[7] *See* Farmers Mutual Telephone in Idaho and Cambridge Telephone in Nebraska, respectively. Farmers Mutual Telephone at 5-7; Cambridge Telephone at 5-7. Other companies filing similar data include Rural Telephone Company (Nevada) at 5-7; Pend Oreille Telephone Company at 5-7; Calaveras Telephone Company at 5-7; Albion Telephone at 5-7; Scio Mutual Telephone Association at 5-7; Kalona Telephone Coop at 5-7; Midvale Telephone at 5-7; Central Texas Telephone Coop at 5-7; Filer Mutual Telephone - Nevada, Northern Telephone Coop at 5-6; Delhi Telephone at 5-7; Nehalem Telecommunications at 5-6; Guadelupe Valley Telephone Cooperative at 5-7; Farmers Mutual Telephone at 5-7; Custer Telephone at 5-7; Interbel Telephone at 5-7. The Iowa Telecommunications Associations (ITA) showed that the combined impact of eliminating high-cost support for corporate operations expense, implementing lower HCLS reimbursement rates as proposed in the NPRM, and moving all access rates to reciprocal compensation levels would in the absence of alternative support result in monthly end-user rate increases of $22.41 for rural Iowans. ITA at 5-6.

[8] Rural Telephone at 7.

[9] Ducor at 7.

- Midvale Telephone Exchange (Idaho) by as much as $47.08, an increase of more than 182.75 percent, bringing the average rate for basic local service to $72.84 per month, not including the Federal SLC, calling features, and taxes and surcharges;[10]

- Filer Mutual Telephone (Idaho) by as much as $40.30, an increase of more 162.09 percent, bringing the average rate for basic local service to $65.16 per month, not including the Federal SLC, calling features, and taxes and surcharges;[11]

- Albion Telephone (Idaho) by as much as $31.96, an increase of more than 124.07 percent, bringing the average rate for basic local service to $57.72 per month, not including the Federal SLC, calling features, and taxes and surcharges.[12]

Many RLECs expressed concern that these reform proposals would seriously threaten their ability to continue serving high-cost areas, as it is unrealistic to expect that these lost revenues can actually be recovered through increases in end-user rates.[13]

Other analyses submitted in comments look at the effects of the Commission's proposed reforms on RLECs' ability to repay existing loans and their ability to secure new financing. For the companies listed above, the impacts of the proposed USF rule changes combined with ICC revenue losses result in significant reductions in the financial ratios included in many loan covenants, including the TIER, the debt service coverage ("DSC") ratio, and the debt-to-earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio. Both the TIER and DSC become negative, thus eliminating for any practical purposes the ability of these RLECs to obtain further debt financing.[14]

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[10] Midvale Telephone at 7.

[11] Filer Mutual Telephone at 6-7.

[12] Albion Telephone at 7.

[13] *E.g.,* Missouri Small Telephone Company Group (MoSTCG) at 3; GVNW Consulting at 28; ITA at 9; SureWest at 8.

[14] *E.g.,* Rural Telephone Company–Idaho at 5-6; Filer Mutual at 5-6; Ducor Telephone at 5-6; Custer Telephone at 5-6.

Likewise, JSI performed financial impact analyses of the Commission's proposed near-term reforms on 139 RLEC study areas, showing the revenue reductions would cause many RLECs to exceed their debt load levels associated with both RUS and CoBank loans.[15] Warinner, Gesinger & Associates (WGA) prepared financial impact analyses for seven RLECs, concluding the Commission's USF proposals will negatively impact these companies' abilities to repay existing loans for infrastructure investments "acquired in reliance on existing USF funding mechanisms."[16] Fred Williamson and Associates provided financial impact analyses of 11 RLECs, GVNW of rural companies receiving HCLS and 30 companies impacted by elimination of corporate operations expense recovery, and Alexicon of 25 companies. Collectively, these analyses demonstrate that the NPRM's proposals "would degrade existing broadband service, waste substantial public resources and cause numerous defaults on substantial obligations owed to the federal government and others, and substitute a failed support methodology for one that has proven to be transparent, responsible and successful."[17]

Comments from other corners only reinforce the factual foundation built by RLECs and their representatives. In comments submitted May 2, 2011, the State Members presented comprehensive financial impact analyses confirming that steep increases in local service rates

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[15] John Staurulakis, Inc. at 6-8 (JSI).

[16] Warinner, Gesinger & Associates (WGA) showed the average estimated annual reduction in HCLS per line for the seven RLECs went from $25.21 in 2012 up to $30.88 in 2015. WGA at 14. Should LSS be phased out, WGA showed the average estimated annual reduction in LSS per line went from $17.81 in 2012 to $40.21 in 2015. *Id.* at 16. WGA estimated the impact of the proposed phase out of corporate operations expense from HCLS would reduce average annual HCLS per line by $3.69 in 2012 to $39.54 in 2015, and the proposed phase out of corporate operations expenses from Interstate Common Line Support ("ICLS") would reduce annual support by $21.01 in 2012, to $70.14 in 2015. *Id.* at 17-19.

[17] State Independent Telephone Association of Kansas at 2. Hill Country was very clear that if the Commission implements its proposed changes to existing high-cost support mechanisms, "Hill Country will fail to meet its CoBank loan covenants in 2012." Hill Country Telephone Cooperative at 4.

would be necessary in most cases for any ICC reform that was not accompanied by a sufficient restructure mechanism ("RM") to compensate carriers for mandated ICC rate reductions.[18] The data showed 46 percent of subscribers would experience rate increases greater than $5.00 if intrastate access rates were reduced to interstate levels, with customers in Alaska experiencing the largest average rate increase, at $16.29. If all ICC rates were dropped to reciprocal compensation rate levels, the national weighted mean effect on local rates would be a rate increase of $11.77, again with Alaskan consumers seeing the largest average rate increase, $25.15.[19] Not surprisingly, the State Members found that the combination of reducing intrastate access rates to interstate levels, eliminating corporate operations expense recovery from high-cost mechanisms, and reducing HCLS reimbursement percentages would be particularly significant. "Among NECA companies, a significant share of carriers in 32 States would have to raise rates by at least $20.00 per month, and in 15 States some rate increases would be at least $50 per month. Debt ratios among NECA companies would degrade to the point that most companies would experience difficulty in raising capital."[20]

As highlighted by the State Members' comments, certain states would be more affected than others, and many state commissions weighed in individually. The Utah PUC points out "cutting support for companies that have incurred indebtedness to build infrastructure in reliance on federal support . . . will injure Utah's rural telecommunications customers, threaten the state's Universal Service Fund, and imperil Utah's rural telecommunications companies."[21] The

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[18] State Members of the Federal-State Joint Board on Universal Service at 67, 102-103 (State Members).

[19] *Id.* at 103.

[20] *Id.* at 117.

[21] Utah Public Service Commission and Utah Division of Public Utilities at 2 (Utah PSC).

Indiana URC stated that a revenue decline "of just five percent (5%) could leave a devastating impact on both the profitability and the viability of these small businesses."[22]

The State Members similarly confirm "providing support for capital costs is an essential prerequisite to the continued flow of private capital into telecommunications networks serving high-cost areas. Bankers and equity investors need to be able to see that both past and future investments will be backed by long-term support programs that are predictable over typical loan repayment periods . . . ."[23] Indeed, at a time when the Commission is seeking to promote broadband deployment – a capital-intensive exercise, to be sure – it would seem at stark odds with such an objective to reduce in such a drastic way the cash flows carriers depend upon to enable network investments and upgrades. The data demonstrate that the proposed reforms would only undermine the Commission's broadband availability and affordability objectives.

By contrast, proponents of such reforms offer little, if any, meaningful data to support these cuts in high-cost support or the massive reductions in ICC rates. For example, in a 65-page filing, Verizon devotes just two pages – without citation to any factual support or detailed discussion of specific proposals – to the claim that rate-of-return "is a relic of a bygone regulatory era."[24] This is perhaps an easy argument for a carrier whose primary approach to offering fixed service in hard-to-serve rural markets has been to exit them altogether, but such claims simply cannot be accepted at face value when they are devoid of any factual support. Windstream, supports many of the NPRM proposals to revise rate-of-return recovery

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[22] Indiana URC at 3. "Regardless of whether revenues are calculated based on jurisdictional (intra- and/or interstate) data or omni-jurisdictional (intra- plus interstate as well as revenues from sources classified previously as "informational services" [e.g. broadband]), it is extremely doubtful that such declines would be survivable." *Id.* *See also* Kansas Corporation Commission at 3.

[23] State Members at 5.

[24] Verizon at 54.

mechanisms (except, of course, those that have the potential for any adverse impact on Windstream), [25] but it too fails to produce any factual discussion of those proposals – there is no quantification whatsoever of actual costs, benefits or impacts associated with proposed reforms to RoR support mechanisms. Instead, its arguments are entirely policy-driven, explaining why it believes its position to be better than the alternative.

In short, the record offers no basis at all to decide that the NPRM's proposed reforms should be adopted. To the contrary, the *only* data in the record confirm that the NPRM proposals would have a widespread and drastic impact on the availability and affordability of voice and broadband services in wide swaths of rural America. It would be arbitrary and capricious on the basis of such a record to proceed with the proposals set forth in the NPRM.

B. Reasonable Alternatives Exist For Accomplishing the Commission's Goals in this Proceeding, Without Causing Widespread Rate Increases, Loan Defaults and/or Service Disruptions.

Recognizing the Commission's desire to address alleged inefficiencies[26] in the existing cost recovery framework for RLECs, the Rural Associations have proposed a targeted approach

[25] Windstream at 33-44.

[26] As CoBank noted, there is "a troublesome tone in the NPRM that suggests the Commission believes that rural carriers that serve high-cost areas are intrinsically wasteful and inefficient. As a lender to this specific sector of the communications industry, we do not believe a fair assessment of the factual data bears this conclusion." CoBank at 3. The Rural Associations share CoBank's concern regarding the Commission's apparent antagonism towards existing High-Cost programs, at least as they apply to RLECs. To the contrary, this is a program of which the Commission can and should be proud. As discussed in the Rural Associations' initial comments (at 64-66), the RLEC-specific portion of today's program is a true success story by ***<u>every</u>*** meaningful measure: reasonably comparable rates, substantial broadband-capable network deployment, high-quality customer service – and all at a "bottom line" support cost that has risen only by three percent on average over the past five years. This is not a program from which the rug should be pulled out; doing so would put at risk all of the very good work this program has done to date. Instead it simply requires recalibration to address specific concerns that will make it sustainable and even more effective and efficient than it already has been.

to constraining growth in high-cost support received by these carriers. Specifically, the RLEC Plan incorporates:

- A limitation on recovery of prospective RLEC capital expenditures based on analyses of booked study area costs to determine the portion of a carrier's loop plant that has reached the end of its useful life and should be eligible for replacement;
- A cap on recovery of corporate operations expenses by applying the current HCLS corporate operations expense cap formula to ICLS and LSS; and
- A $25 local voice service rate benchmark that is applied in conjunction with an RM to compensate RLECs for revenues lost from reducing intrastate switched access rates to interstate levels on a company-specific basis.

As explained in the Rural Associations' initial comments, these alternative near-term proposals would address the most significant alleged inefficiencies in the cost recovery framework for RoR carriers, take a more targeted approach to constraining growth in high-cost support received by these carriers, and allow the first step of ICC reform to be taken – all without risking dramatic rate increases or service disruptions for rural consumers and businesses or causing RLECs to default on existing loans.

Moreover, the RLEC Plan would allow the Commission to begin the process of transitioning from existing high-cost support mechanisms to a new RLEC-specific component of the CAF. As soon as the new RLEC-specific CAF mechanism is implemented, RLECs can begin receiving support for their active broadband lines and transition additional broadband network costs into the new support mechanism over time, as the adoption-based interstate allocation factor phases in and customers increasingly subscribe to broadband service.

As discussed in comments, the RLEC Plan focuses on ensuring "reasonably comparable" broadband services are available in high-cost areas at reasonably comparable rates, in conformance with section 254 of the Act. It does little good to make advanced services available in rural areas if they are then too expensive to buy, too low quality to address real consumer

demand, and/or too speculative an investment to sustain or upgrade. The statutory mandate for universal service includes not only making broadband service available in unserved areas, but also ensuring every customer will continue to receive reasonably comparable services at reasonably comparable rates.[27]

This is a key facet of the statute that all too often seems to be lost in the race to address "unserved" areas through reform. The RLEC Plan achieves *both* objectives by enabling the *deployment* of broadband-capable networks deeper into the unserved portions of RLEC service areas, and ensuring that currently-served rural consumers in these territories do not suffer *loss or degradation of service* or otherwise fall behind in terms of receiving reasonably comparable services – all at support cost increases that are no greater than the rate of inflation. . The long-term success of broadband services in rural America demands such a comprehensive perspective, and this Commission should be looking to make *sustainable* broadband its legacy.

The RLEC Plan is not only consistent with the Commission's desire for market-driven reforms, but also provides the opportunity for long-term revenue stability that is required for private investment and continuity of service for rural consumers and businesses. Comments received by the Commission clearly demonstrate that sweeping changes based upon predictive judgments may fail to consider fully all of the potential short-term and longer-term consequences, nor allow for timely adjustments to be made to account for market reactions. This is why the RLEC Plan incorporates "pause points," to allow the Commission and industry to take account of market developments as well as market reactions to the Commission's reform measures. In addition, by working within the existing legal and jurisdictional structures, the

[27] Section 254 also requires the Commission to seek to narrow differences between rural and urban rates over time. *See Qwest Corp. v. FCC,* 258 F.3d 1191 (10th Cir. 2001) ("*Qwest I*"); *Qwest Communications Int'l Inc. v. FCC*, 398 F.3d 1222 (10th Cir. 2005) ("*Qwest II*").

RLEC Plan provides for a smooth "glide path" from legacy high-cost mechanisms to a new RLEC-specific component of the CAF that will support responsible broadband deployment and upgrades, as well as encourage increased adoption in these areas.

III. THE USF REFORM PROPOSALS DESCRIBED IN THE NPRM WILL, IF ADOPTED, LEAD TO LITIGATION, INTRODUCE LEGAL AND PRACTICAL COMPLICATIONS, AND DELAY RATHER THAN IMPROVE BROADBAND DEPLOYMENT AND ADOPTION.

In comments, the Rural Associations – along with many other parties – emphasized the importance of assuring consistency between proposed reforms and present-day legal and economic realities. However desirable it may seem to move quickly towards an "end game" premised upon an all-Internet Protocol ("IP") network, the Commission cannot simply ignore the provisions of the Act, nor can it avoid confronting the practical realities and challenges faced by consumers, businesses, and RLECs who reside and operate in high-cost, rural areas.

Concerns regarding the legal and practical difficulties associated with the NPRM's long-term USF proposals are amply borne out by the comments. Indeed, the record highlights the need to stay within the bounds of the governing statute in undertaking USF reform; otherwise, actions taken in this proceeding will not advance the goals of the National Broadband Plan,[28] but instead enmesh the Commission and the industry in unending controversies and legal battles.

The following discussion identifies several key legal and practical flaws identified in the record with respect to the NPRM's approach to long-term high-cost USF reform, and suggests ways the Commission can avoid these pitfalls by pursuing reform in a manner that is consistent with the Act and the rural telecommunications environment.

[28] Connecting America: The National Broadband Plan, FCC (rel. Mar. 16, 2010) at 141 (*NBP*).

A. High-Cost Support Must Be Directed To Support Telecommunications Services Provided by Eligible Telecommunications Carriers.

To carry out its reform objectives, the Commission proposes a new principle for universal service policies – specifically, "that universal service support should be directed where possible to networks that provide advanced services, as well as voice services."[29] The Rural Associations concur with and applaud this basic principle. Adopting such a principle, however, does not empower the Commission to take legal "short-cuts" or to sidestep any limitations in the underlying statute, no matter how commendable the proposed policy or desirable the result. The Commission must still traverse the threshold legal question of what authority is conferred by the Act to provide high-cost universal service support for non-regulated broadband Internet access services.[30] As described below, there is a clear and straightforward roadmap by which the Commission can achieve this objective consistent with the Act. If it is not careful in this regard, however, comments make clear the Commission runs the substantial risk of establishing a 21st Century universal service support mechanism that rests on very shaky statutory underpinnings.

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[29] NPRM ¶ 55, *quoting Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, *Lifeline and Link Up*, WC Docket No. 03-109, Recommended Decision, 25 FCC Rcd 15598 (2010) ¶ 75 (*Joint Board 2010 Recommended Decision*).

[30] The Commission has made a carefully calculated and painfully deliberate choice in recent years to classify broadband Internet access as an information service. *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, *Universal Service Obligations of Broadband Providers* (Docket No. 02-33); *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services* (Docket No. 01-337); *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements* (Docket Nos. 05-20, 98-10); *Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Services Provided via Fiber to the Premises* (Docket No. 05-271); *Consumer Protection in the Broadband Era* (Docket No. 05-271): Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ¶ 14 (*Wireline Broadband Order*). *See also Preserving the Open Internet*, GN Docket No. 09-191, *Broadband Industry Practices*, WC Docket No. 07-52, Report and Order, 25 FCC Rcd 17905 (2010).

Section 254(b) sets forth principles upon which the Commission is required to "base policies for the preservation and advancement of universal service."[31] These principles, however, do not supersede the enabling provisions of section 254. This is not to say the Commission can ignore these principles in implementing reform; to the contrary, it is duty-bound pursuant to statute to make them the essential foundation for any reforms it may undertake and any programs it may implement. Indeed, any reform that failed to take account of these principles would be doomed to failure as a practical matter and would almost certainly fail upon appeal as a legal matter. At the same time, however, the Commission cannot use these principles to *trump* contrary indications that may lie within the operative provisions of section 254.

With respect to high-cost support, the principles of section 254(b) must be implemented within the operative confines of section 254(c), which define (and accordingly limit) "universal service" as "an evolving level of *telecommunications* services."[32] Thus, while it is true that section 254(b) requires that rural consumers have reasonably comparable access to "advanced telecommunications and *information services,*" it may be a step too far to contend that this must be achieved through direct funding of non-regulated broadband Internet access service.[33] As an information service, the square peg of Internet access services cannot be forced into the round hole of an operative statute that refers only to telecommunications services.[34]

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[31] 47 U.S.C. § 254(b)(1)-(6).

[32] 47 U.S.C. § 254(c)(1) (emphasis added). The statute continues, in pertinent part, to explain that the Commission shall establish the definition of "telecommunications services" periodically, "taking into account advances in telecommunications and information technologies and services."

[33] NPRM ¶ 61 (emphasis added).

[34] Comments provide little support for alternative conclusions. For example, while AT&T (at 113) asserts correctly that section 254(c)(1) "rejects a static focus on legacy technologies," the plain language of that provision expressly refers to <u>*telecommunications*</u> services – and not to information services. *Cf*. Comcast (at 21) argues that section 254(c)(1)'s limited reference to

Moreover, as the Rural Associations showed in their initial comments, the express language and legislative history of sections 254(e) and 214(e)(1) of the Act authorize the Commission and its agents to distribute CAF and other federal high-cost support solely and entirely to common carriers that have been designated as ETCs by the appropriate jurisdictional authority.[35] Thus, while the Commission is required to promote access to advanced telecommunications and information services pursuant to sections 254(b)(2) and (b)(3), such policies must still be undertaken within the limits imposed by sections 254(c)(1) and (e) and section 214(e)(1).[36]

Other commenting parties, including the National Association of Regulatory Utility Commissioners ("NARUC"), the National Association of State Utility Consumer Advocates ("NASUCA") and COMPTEL, share the same reading of sections 254 and 214.[37] NARUC rightfully declares that these statutory provisions make matters "crystal clear that only telecommunications carriers, as defined in 47 U.S.C. §153(44), can lawfully receive USF support."[38] COMPTEL asserts that the Commission "needs to fund network infrastructure" in

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"telecommunications services" should be ignored because other provisions in section 254 are not limited to telecommunications services). Verizon (at 63-64) claims that the Commission's proposals to fund broadband Internet access services "are on the right track," but does not offer any specific legal support for the Commission's authority to fund non-telecommunications services.

[35] Rural Associations at 81-82.

[36] Interestingly, AT&T's reliance on principles in section 254(b) to expand this substantive grant of authority not only conflicts with the plain language of other provisions of the Act, but also with AT&T's own line of argument in the "net neutrality" debate. *See, e.g.,* AT&T Comments, GN Docket No. 09-191, WC Docket No. 07-52, at 217 (filed Jan. 14, 2010) ("Policy may *guide* the Commission's action, but it cannot provide a substitute for the statutory authority required to undertake the action in the first instance.") (emphasis in original).

[37] *See also* RTCC at 6; TCA at 10; Cellular South at 20.

[38] NARUC at 3. NASUCA agrees with this statutory analysis, concluding: "[t]hus, non-telecommunications carriers and non-common carriers cannot receive USF." NASUCA at 28.

order to ensure that all Americans have access to voice telephone and broadband service, and that the Commission "cannot possibly legally justify providing high cost support to [information service providers] that are not telecommunications carriers in direct contravention of sections 254 and 214."[39] COMPTEL concludes that the "Commission's responsibility as steward of the billions of dollars in high cost funds that are collected from rate payers includes the very serious obligation not to authorize use of the funds to subsidize services or providers other than those the statute authorizes."[40]

Perhaps anticipating these concerns, the Commission has asked whether section 706 of the Act, its ancillary authority pursuant to Title I, and/or its ability to forbear from certain legal requirements under section 10 of the Act may offer alternative legal bases for distributing high-cost universal service support.[41]

Section 706 provides no means of circumventing sections 214 or 254. Section 706 merely directs that the Commission "*shall take immediate action* to accelerate deployment of such capability by removing barriers to infrastructure investment and by promoting competition in the telecommunications market."[42] The D.C. Circuit has stated that "[t]he general and generous phrasing of section 706 means that the FCC possesses significant, albeit not unfettered, authority and discretion to settle on the best regulatory or deregulatory approach to broadband."[43] But the directive to "take immediate action" is limited to action the Commission is

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[39] COMPTEL at 29-30.

[40] *Id*. at 30.

[41] NPRM ¶ 60 (internal citations omitted).

[42] 47 U.S.C. § 1302(b) (emphasis added).

[43] *Ad Hoc Telecom. Users Comm. v. FCC*, 572 F.3d 903, 906-07 (D.C. Cir. 2009).

authorized to take in the first instance. The Commission cannot invoke section 706 to abrogate other obligations or to sidestep the limits of authority granted elsewhere in the Act.[44]

The Commission is also empowered under the Act with "ancillary jurisdiction" to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions."[45] To justify an exercise of such authority, the Commission must satisfy two prongs: first, it must act under the "general grant of jurisdiction under Title I of the Communications Act, which … encompasses 'all interstate and foreign communication by wire or radio;'"[46] and second, the Commission's action must be "reasonably ancillary to the effective performance of the Commission's various responsibilities."[47]

To be "reasonably ancillary," however, the Commission must find a substantive statutory tether to which it may append the exercise of ancillary authority.[48] As NASUCA aptly summarized, any exercise of ancillary authority by the Commission "must be found in more specific provisions of the Act that grant such authority, rather than those that merely set forth

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[44] NARUC and NASUCA agree that the general provisions of section 706 do not explicitly or implicitly address, modify or expand the Commission's express and limited sections 254(e) and 214(e) authority to distribute universal service support. NARUC at 6; NASUCA at 32. *See also* RTCC at 13 (noting that section 706 contemplates removal of regulatory barriers to infrastructure investment, rather than enabling development of new regulations such as novel USF mechanisms).

[45] *American Library Ass'n v. FCC,* 406 F.3d 689, 692 (D.C. Cir. 2005); *see also* 47 U.S.C. § 154(i).

[46] *United States v. Southwestern Cable Co.*, 392 U.S. 157, 167 (1968) (quoting section 2(a) of the Act, 47 U.S.C. § 152(a)).

[47] *Id.* at 178.

[48] *See* RTCC at 14 (quoting *Board of Governors of Fed. Reserve Sys. V. Dimension Fin. Corp.*, 474 U.S. 361, 373-74 (1986). ("As the Supreme Court has stated, the FCC's ancillary authority does not give the FCC the power to . . . 'expand its jurisdiction beyond the boundaries established by Congress.'")

policy aspirations."[49] There is no such specific tether to be found, however, in sections 254 or 214 – those provisions set forth straightforward definitions of who may receive high-cost support and for what purpose such support may be distributed. As the U.S. Court of Appeals for the District of Columbia Circuit has stated, to justify an exercise of ancillary authority, the Commission must adequately explain how "its regulation of an activity over which it concededly has no express statutory authority . . . is necessary to further its regulation of activities over which it does have express statutory authority . . . ."[50] Ancillary jurisdiction does not, however, permit the Commission to create new "statutorily mandated responsibilities"[51] by rewriting sections 254 and/or 214 of the Act to use statutorily-defined support mechanisms in an unauthorized manner.

Finally, the Commission's ability under section 10 of the Act to forbear from enforcement of certain legal requirements does not enable it to override section 254(c). Forbearance merely permits the Commission to refrain from applying statutes or regulations that apply "to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services."[52] Section 10 does not empower the Commission to expand its own authority, or to decide that a statutory provision that applies only to telecommunications services should apply to *other* services. In other words, forbearance could perhaps be used to *excuse* telecommunications services from a certain regulation or statutory obligation, but it cannot be used to *include* non-telecommunications services *within* a statutory framework that applies only to telecommunications services.

[49] NASUCA at 29 (citing *Comcast Corp. v. FCC*, 600 F.3d 642, 654-55 (D.C. Cir. 2010)).

[50] *Comcast*, 600 F.3d at 654.

[51] *See id*. at 655.

[52] 47 U.S.C. § 160(a).

NARUC and NASUCA agree that the Commission may not use the forbearance provisions of section 10 of the Act to eliminate or modify the statutory responsibilities and limitations conferred by Congress upon the Commission and state commissions.[53] Rather, as NARUC indicates, the plain language and legislative history of section 10 is limited to forbearance from statutory provisions or regulations applicable to telecommunications carriers or services, or classes of such carriers or services.[54] In NASUCA's words, "forbearance" from limitations imposed on the Commission itself "would not create authority to provide support for broadband or allow support to non-ETCs, but would instead 'create a vacuum' where there would be no authority."[55]

To be clear, in raising such concerns about how the Commission may go about distributing high-cost support, the Rural Associations do *not* object to the Commission's ultimate objectives. In fact, the Rural Associations applaud and support efforts to promote the availability and affordability of broadband Internet access service throughout high-cost, rural areas, and they further believe the Commission clearly possesses the ability and authority to achieve these objectives. What is in debate here is simply the process – the authorized means – by which the Commission may go about directing support toward these purposes. In the end, overwhelming support for a policy objective does not translate into legal authority to reach that end by any means possible. The Commission must instead respect the limitations on the distribution of high-cost universal service support imposed by sections 214 and 254.

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[53] NARUC at 7; NASUCA at 33-34; *see also* State Members at 86-88.

[54] NARUC at 7.

[55] NASUCA at 33-34 (quoting *Core Comms. v. FCC*, 545 F.3d 1 (D.C. Cir. 2008)); *see also* RTCC at 16 ("The Commission cannot shoehorn a regulatory flexibility provision specifically meant for the promotion of competition and the regulation of rates and charges into Congressional permission to ignore non-germane universal service provisions of the Act in section 254 and section 214(e).")

Fortunately, the Act provides a clear path forward for the Commission to take in lieu of any legal "short-cuts." As discussed in the Rural Associations' initial comments, the Commission is clearly authorized to condition the receipt of high-cost universal service support on express agreement by an ETC to treat the transmission component of "broadband Internet access service" as a telecommunications service that will be offered on a stand-alone common carrier basis.[56] The Commission's policies enabling support for the provision of broadband Internet access transmission on a Title II common carrier basis have been wildly successful in promoting effective and efficient availability of retail broadband services in wide swaths of rural America.[57] Continued distribution of CAF and other federal high-cost support to ETCs offering services on a common carriage basis will clearly comply with the statutory mandates of sections 254(e) and 214(e)(1); will continue to provide investment incentives and financial resources for the construction, upgrade, operation and maintenance of essential rural broadband-capable infrastructure; and will avoid the disruption, delays and uncertainty of potential judicial challenges.

B. Universal Service Reform Must Take Into Account the Critical Role RLECs Play as "Carriers of Last Resort" in Rural America.

Many commenters in this proceeding highlight the continuing value of COLR policies and requirements, which have increased service availability and ensured service continuity – particularly in the sparsely populated and high-cost rural areas that most wireline and wireless

[56] Rural Associations at 81-82. *See also Wireline Broadband Order,* 20 FCC Rcd 14853 (2005) ¶ 90.

[57] *See* NECA *Trends 2010*- A report on rural telecom technology (at 5) (available at https://www.neca.org/cms400min/NECA_Templates/PublicInterior.aspx?id=100) (showing NECA members offer broadband services to over 92 percent of their customers, albeit at varying speeds.).

carriers have declined to serve.[58] These comments confirm that the Commission should pursue the development of reasonable, well-tailored requirements (tied to the receipt of sufficient high-cost support) as a means of achieving the accountability that is one of its core reform principles. Imposed under section 214(e) of the Act, various state statutes, state public utility commission regulations, RUS loan covenants, and telephone cooperative bylaws, COLR requirements have been very successful in extending universal service to unprofitable or otherwise unattractive areas as well as improving the public health, safety and welfare of the residents of such areas.[59]

Some commenters nevertheless claim that COLR obligations have become obsolete in today's telecommunications marketplace.[60] State commissions charged with overseeing service provisioning in rural areas recognize, however, the continuing importance of COLR requirements in a broadband world. The Michigan PSC, for example, declares that:

> [f]or several decades, both federal and state governments have relied on the responsibilities of the wireline COLR to continue to provide telecommunications service to high cost areas and low income customers. The transition into broadband does not mean that wireline telecommunications is now extinct or that the COLR responsibilities are no longer necessary.[61]

The Regulatory Commission of Alaska ("Alaska Commission") not only proclaims the benefits of COLR requirements, but also advocates the continued primacy of state COLR jurisdiction and responsibilities for the evolving broadband future:

> States are in best position to assess the need for and services to be provided by COLR carriers. Alaska has recently adopted regulations to select the COLR in a competitively

[58] Rural Associations at 69-75; GVNW at 28; TDS at 8; TCA at 8; WGA at 42.

[59] At the same time, existing COLR requirements impose burdens upon RLECs and other COLRs, including substantial unrecovered capital expenditures and outstanding construction loan balances, ongoing above-average operating expenses, exacting service and service quality obligations, and significant regulatory and reporting burdens. *See, e.g.* State Members at 127.

[60] *E.g.,* AT&T at 62.

[61] Michigan PSC at 6.

> neutral manner and in many cases, provide state USF funding to the COLR. Our actions demonstrate our belief that preservation of a COLR in rural Alaska is critical to the public interest. We oppose proposals that attempt to eliminate COLR responsibilities or interfere with our ability to select the most reasonable COLR to serve an area. Absent such coordination, a carrier of last resort's relinquishment of ETC status would lead to degradation of services in rural Alaska communities where costs are high, there is no business case for deploying services, and consumers have little or no choice among alternative services.[62]

Mid-sized and larger ILECs have also been subject to COLR requirements. As the Independent Telephone and Telecommunications Alliance ("ITTA") indicates:

> COLR requirements were developed in the context of voice service regulation to ensure that as many customers as possible could obtain services at reasonable prices. The FCC recognized the importance of the COLR principle in the National Broadband Plan. To meet COLR responsibilities, ILECs were required to build networks near to where customers reside so that prompt service could be provided to those who request it. The resulting nearly ubiquitous network has redounded to the benefit of broadband customers who receive service over the same network. If current support needed to make service economically viable is diverted from a COLR to a lower-cost-per-unit provider in another area, COLR obligations would be jeopardized. Such diversions would discourage COLRs from investing their own funds in marginal economic areas within their territory, undermining the private investment the Commission is seeking to expand broadband in rural areas.[63]

RLECs have operated as COLRs for decades with respect to their former voice-only networks as well as their current multiple-use networks. They are committed to remaining in this role as their networks transition to all-broadband/IP, so long as they have access to sufficient cost recovery mechanisms to do so. They are fully aware that COLR requirements are unnecessary with respect to the profitable customers that all carriers want to serve. Rather, COLR regulation comes into play only where particular customers or areas are unattractive to most carriers because of their remote locations, high costs of service, and/or minimal profit potentials.

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[62] Regulatory Commission of Alaska at 24.

[63] Independent Telephone and Telecommunications Alliance (ITTA) at 18.

It is just and reasonable for carriers to be required to serve economically less attractive customers as a condition of their common carrier authorizations, ETC designations and receipt of sufficient USF funding. Likewise, customers in rural and other high-cost areas should be able to identify and rely upon at least one conspicuous COLR from which they can obtain service upon making a reasonable request for it. At a time when the Commission has made accountability one of its core reform principles, it would seem self-contradictory to excuse providers from compliance with key service obligations that follow from use of federal dollars.

Indeed, there would appear to be no better way of ensuring accountability in the use of scarce and valuable resources than to require that high-cost support recipients deliver on the promise of broadband – both by deploying broadband-capable networks in rural America and then ensuring that affordable, high-quality advanced services are readily available to all consumers in the areas served by those networks. Therefore, the Rural Associations continue to recommend that strict, reasonable and well-defined COLR requirements be adopted and implemented with respect to the broadband services supported by the CAF.

C. Including Non-Regulated Revenues In High-Cost Support Calculations Would Create A Legal And Practical Quagmire.

The NPRM asks whether the Commission should take account of non-regulated services in determining the need for cost recovery of multi-purpose networks, and if so, how it might evaluate whether a provider's revenues are sufficient to preclude the need for additional recovery through regulatory support mechanisms.[64] These questions blur what has heretofore been a clear line between regulated and non-regulated operations, and pose the substantial risk of creating legal and practical quagmires with respect to what services are being supported and the determination of what support is needed.

[64] NPRM ¶ 568.

By way of background, the Commission has emphasized for several decades the essential importance of separating regulated and non-regulated costs and revenues.[65] RLECs have adhered to this policy through compliance with stringent separations, cost allocation, and accounting policies.[66] Indeed, it is still the case that the Universal Service Administrative Company ("USAC") – the party primarily charged by the Commission today (and presumably in the future) with ensuring accountability in use of high-cost support – makes one of its primary audit missions the determination of whether separation between regulated and non-regulated accounts has been adequately respected.[67] Although the Commission understandably desires to "fund broadband," here again it must take careful account of the constraints of the Act and its own long-standing regulatory policies in doing so. For example, the Commission has determined repeatedly in recent years that broadband Internet access service is deregulated.[68]

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[65] The Supreme Court has stated the basic rule for the treatment of unregulated revenues and costs for federal ratemaking purposes as follows: "Ratemaking is, of course subject to the rule that the income and expense of unregulated and regulated activities should be segregated." *FPC v. United Gas Pipe Line Co.*, 386 U.S. 237, 243 (1967). *See also Michigan Bell Tel. Co. v. Engler,* 257 F.3d 587 (6th Cir. 2001). That case held, *inter alia*, an ILEC cannot be "required to subsidize [its] regulated services with income from rates either deemed to be competitive, or with revenues generated from unregulated services." *Id.* at 594.

[66] *See* 47 C.F.R. Part 64; *see also, Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Report and Order, 11 FCC 17539 (1996) ¶ 74 ("Our Part 64 cost allocation rules require a carrier to assign costs directly, wherever possible, to regulated or non-regulated activities. These rules protect subscribers to interstate exchange and exchange access services from bearing the costs and risks of the carrier's non-regulated activities provided on an integrated basis.")

[67] *See, e.g., Prevalent Audit Issues: High Cost Audits' "Greatest Hits,"* presentation by Rob Binder, USAC High Cost/Low Income Division, at 7 (describing as one of the audit processes' "Greatest Hits" the examination of whether Part 64 separations have been properly performed, whether adequate documentation has been maintained to support cost allocations between regulated and non-regulated operations, and whether expenses have been properly assigned and applied to different accounts) (available at: http://www.usac.org/_res/documents/hc/pdf/training-2010/Audits-Compliance-Common-Findings.pdf).

[68] *Wireline Broadband Order*, 20 FCC Rcd 14853 (2005) ¶ 136.

Given the controversial nature of these decisions, [69] the Commission presumably is not eager to revisit this determination anytime soon. Yet by suggesting it may need to take account of non-regulated operations in calculating high-cost universal service support, the Commission would effectively run headfirst back into the debate of how to regulate broadband Internet access services – and potentially expand that controversial debate to other "non-regulated" services as well.

Indeed, adopting such a broad-brush approach to determining the need for high-cost support would give rise to a whole host of questions. If it proceeds in this manner – assuming it has authority to do so – the Commission would need to define which non-regulated operations are included within the calculation of high-cost support. For example, should video revenues and expenses be included?[70] What about remote alarm monitoring revenues and expenses, or wireless data plan revenues and expenses? What if the would-be USF recipient operates a retail store, a carwash, a construction business, or a data center – should the net revenues from those operations be included in support calculations?

Furthermore, what if certain non-regulated revenues or expenses are realized by and booked in an affiliate? Are such net revenues and costs to be used in the determination of needed support, and if so, what kind of affiliation is required to trigger attribution? Thus, as just a first step, the Commission would need to consider the logical and legal/jurisdictional bases for the various non-regulated operations that might be incorporated in support calculations. It would also have to explain why any single category of non-regulated revenue and expense had been

[69] *See Comcast v. FCC*, 600 F.3d 642 (D.C. Cir. 2010).

[70] The State Members suggest (at 34-35) that video revenues and expenses should *not* be included in any determination of need for support. As RLEC entities have repeatedly informed the Commission (and as the State Members seemed to acknowledge), the high costs of video content have precluded most RLECs from realizing net income for their video services.

included within the high-cost support calculation while another seemingly similar or related category of non-regulated revenue or expense had been excluded. [71]

Following completion of these thorny initial tasks, the Commission would need to determine how it can ensure proper accounting treatment of specific non-regulated operations – *i.e.*, are the revenues and expenses accurately stated and accounted? How would USAC make that determination for services that are not subject to Commission regulation? Of perhaps even greater concern, the Commission would also need to ensure that the revenues and expenses associated with the non-regulated operations are just and reasonable; the Commission presumably would not want a provider to recover an inordinate amount of high-cost support simply because, for example, its retail Internet service marketing budget or Internet operational costs were unreasonably high. At a time when the Commission is demanding greater accountability in the use of USF funds and greater efficiency from USF recipients, it cannot leave open the possibility that differences in service classification, accounting treatment, or the rate packages of non-regulated services could drive varying levels of high-cost support.[72]

To ensure consistency and integrity in the system, the Commission would therefore need to provide detailed guidance – much as the current accounting and separations rules do today – regarding how non-regulated revenues and expenses must be recognized, reported, and accounted for in calculating the ultimate amount to be received in high-cost support. The

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[71] For example, the State Members seem to recommend, without explanation, that the Commission take account of *all* broadband Internet access revenues but only *some* non-regulated broadband Internet access expenses (*i.e.,* transmission costs) in determining support needs. *Id.* at 33-34, 47-48. It should also be noted that the same definitional and categorization complications described above would almost certainly arise in any attempt to allocate costs or otherwise take account of non-regulated operations.

[72] As ITTA observes, "[t]o include other services in the analysis [of needed high-cost support], the Commission would have to determine an affordable rate for each of those services, which would add further complications." ITTA at note 80.

Commission would also need to ensure that USAC is equipped with adequate resources and clear guidance to administer a program expanded far beyond regulated telecommunications services. For example, USAC would need to know how to take account of cable TV revenues and costs (if video were included) and Internet marketing expenses (assuming Internet access services were included) in validating whether a USF recipient required a certain level of support.

In short, by including non-regulated operations in the determination of what level of high-cost support should be provided, the Commission would put itself in the inevitable and unenviable position of either: (a) having to trust that providers will "get it right" in accounting for and reporting on the revenues and expenses of non-regulated operations without any guidance therefor (or regulatory auditing thereof); or (b) publishing and enforcing requirements as to how providers will account for and report on non-regulated operations and the procedures by which USAC would then ensure that distributions accurately reflect those operations. Put another way, if the Commission were to proceed in such a manner, it would paradoxically be in the position of either distributing regulated support payments based in significant part upon providers' own determinations with respect to non-regulated operations (thereby undermining accountability and fiscal responsibility), or effectively "regulating" what have traditionally (or recently) been non-regulated operations.[73]

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[73] Moreover, to ensure that high-cost support is distributed in a nondiscriminatory and competitively neutral manner, the Commission would need to apply any such broader review of net regulated and non-regulated revenues for USF/CAF support to *all* potential recipients to determine the true "need" for support of each. As just one example, it is hard to see how a company that reported $106.5 billion in total revenues and $63.4 billion in domestic wireless revenues, with 3.4 million FiOS customers, *see* Verizon 2010 Annual Report at 17, 37 (available at: http://www22.verizon.com/investor/investor-consump/groups/financial/documents/investorrelation/annual_2010.pdf), and that also stands to obtain substantial windfalls from ICC reductions if the Commission's proposed reforms take effect, would require high-cost support to enable investment in high-cost areas. In any event, if the Commission pursues the approach of taking net regulated and non-regulated revenues into

Here again, the Commission would be better served by working within the confines of the Act and its long-standing regulatory framework rather than tossing aside decades of practice and policy that have helped to ensure the integrity and success of the High-Cost program.[74] To remain consistent with the principles of fiscal responsibility and accountability, and to avoid the legal and practical quagmire that would arise in determining whether and to what degree certain non-regulated revenues and expenses should be included within any high-cost support calculation, the Commission should determine support based upon well-defined and time-tested rules governing the accounting and reporting of regulated revenues and expenses.

D. Costs and Complications Associated with Redrawing Study Area Boundaries Based on the Presence of "Unsubsidized" Competition Will Far Outweigh Likely Benefits.

Several commenters urge the Commission to limit distribution of high-cost support to those geographic areas in which there is no "non-subsidized provider."[75] In a simplistic rush to reach their desired result, however, these commenters breeze past the substantial concerns and complications associated with such an approach – including, but not limited to, the fundamental questions of: (1) how one determines whether a "non-subsidized provider" is present; and (2) whether eliminating support in the competitive "donut hole" within a study area would actually *increase* demand pressures on the size of the fund because of the impact on outlying "donut"

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account for some form of a "total company stress test" of support need, it must do so for *all* recipients – including large LECs, mid-sized LECs, and any other ETCs.

[74] *See supra* note 26. *See also* Universal Service Administrative Company, Final Report and Statistical Analysis of the 2007-08 FCC OIG High Cost Program Beneficiary Audits (Dec. 15, 2010) (finding the 2008 High Cost Program Beneficiary Audits report issued by the Office of Inspector General significantly erred when it determined the high-cost program had an improper payment rate of 23percent. USAC's final report showed the correct estimated improper payment rate to be 2.7 percent).

[75] Verizon at 62; *see also, e.g.*, Sprint at 35, NTCH at 2; RCA at 12; US Cellular at 70.

areas. It is hard to see how the Commission could adopt such a major modification to the calculation and distribution of high-cost USF at this time when those who urge this approach provide neither details of how to accomplish it nor any meaningful examination of the relative costs and benefits of implementing it.

As an initial matter, the only discernable benefit from such a process is to competitors (e.g., CATV providers) who typically serve only the most densely populated (*i.e.*, relatively lowest-cost) portion of a high-cost area, and would gain an advantage if ILECs lose high-cost support for in-town areas while still being required to continue service in both the town and the surrounding low-density areas. Based upon the Rural Associations' review of the comments, no commenter has identified any other benefit to be derived from this effort.

On the other side of the ledger, the costs of this approach would be significant – both to the customers who depend today upon a COLR in both the "donut" and the "donut hole" and to the system as a whole. First, there are few, if any, savings to be realized through this process. The Commission itself has observed that, "by determining the need for support in smaller areas, total support levels in some areas may increase because there would be little or no cross-subsidy from lower cost areas within the carrier's service area."[76] In fact, re-calculating needed support amounts for outlying rural areas on a stand-alone basis, without the benefit of averaging in the costs of serving more densely-populated areas where there may be a competitive presence, would almost certainly increase the overall level of support needed to serve the highest-cost customers across the country. This directly contradicts and undermines the Commission's desire to *constrain* growth in the USF. [77]

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[76] NPRM ¶ 388.

[77] As the Rural Associations pointed out in their initial comments, it took what USAC has described as a "large-scale effort" to disaggregate the service areas of only a handful of carriers

Finally, to the extent an ILEC were no longer receiving support in a competitive "donut hole," presumably it should have the choice to be released from any and all obligations associated with serving as a COLR in that area. This would mean that customers who have relied upon the presence of the ILEC, even as other competitors could come and go as they choose (or potentially deny service altogether to certain customers), are now at the mercy of an ostensibly well-developed "market" where two or so providers can choose to serve or not serve certain customers.[78]

Beyond the fact that proponents of redrawing study areas based on the presence of "unsubsidized" competition provide no hard evidence or meaningful thought regarding the relative costs and benefits of this proposal, advocates this approach are also evasive (at best) with respect to how this proposal would actually work. Verizon, for example, contends that high-cost support should go only to those places where "there is no business case for a provider to provide [service at reasonably comparable rates]," and that the rationale for such support "disappears entirely" where a provider is operating without USF subsidies.[79] Sprint likewise asserts in the course of a few sentences, and without any legal or factual elaboration, that it is "both inefficient and anti-competitive to provide subsidies to incumbent carriers that allow them to undercut the market-based rates charged by unsubsidized competitors in that market."[80] But the fact that a provider may be operating without high-cost support does *not* translate into a conclusive

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pursuant to rules adopted in the Commission's 2001 *MAG Order*. Rural Associations at 47-48, *citing* USAC, *Understanding Disaggregation* (available at http://www.usac.org/hc/about/understanding-disaggregation.aspx).

[78] *See* ITTA at 30 ("Removing support based on the existence of competition in only part of a geographic area would harm the remaining customers that are served only by the supported ILEC. Without the support that made the initial investment possible, the ILEC could eventually be forced to cease providing service to the remaining customers.")

[79] Verizon at 62.

[80] Sprint at 35.

determination that the area in question is in fact "economic" to serve, that the competitor is truly "unsubsidized," or that the rates charged by the competitor in that area are in fact "market-based."

There are several reasons these correlations cannot be drawn without more information and careful consideration. First, one cannot simply conclude that an area is "economic" to serve or that a competitor is really "unsubsidized" simply because that competitor does not happen to obtain *USF* support for that area. As the Small Company Committee of the Louisiana Telephone Association rightly pointed out, the premise that funding should no longer be available where a competitor exists:

> ignores situations where there may be cross subsidization between a competing carrier's urban and rural operations. . . . Cable competitors may even offer lower rates in rural areas than rates available in urban markets because they are able to offset the lower rural rates with greater margins from their more concentrated urban markets.[81]

This observation is critical. If the objective truly is (as Verizon claims) to identify areas in which a "business case" exists to provide service without support, the Commission must take into account more than just the explicit support that might be received by a provider for operations in that area. It must also consider the extent to which a competitive provider is cross-subsidizing its operations in an otherwise "uneconomic" area through operations in more densely populated and profitable areas. For this reason, if the Commission chooses to proceed in this fashion – notwithstanding the substantial concerns and complete lack of demonstrable benefits associated with doing so – any competitor seeking to establish a competitive "donut hole" must be required to present clear and convincing evidence demonstrating that the area is indeed

[81] Small Company Committee of the Louisiana Telecommunications Association at 15 (LTA).

"economic" of its own accord and can support a *stand-alone* business plan.[82] Without these data, the Commission runs the substantial risk of declaring "false positives" – reducing or eliminating high-cost support in an ostensibly "competitive" area notwithstanding the fact that support may be warranted based upon the actual cost characteristics of those areas.

The Rural Associations therefore urge the Commission to proceed with great caution before deciding to undertake – or, more appropriately, prompting the states to undertake – any initiatives to redraw study area boundaries. There is no need or reason to begin such efforts now, when the benefits to be derived have yet to be identified and the next steps of high-cost reform remain unclear. Instead, the Commission should establish clearly how the CAF will operate in its "future-state" following a Phase I transition, including the geographic scope for which support would be provided in any given area. The Commission can then decide whether to undertake (or prompt) revisions to study areas if and when a competitor seeks to establish the presence of a truly unsubsidized competitive area. This is a more logical and orderly approach than requiring

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[82] The Rural Associations' comments (at 51-65) outlined the detailed processes the Commission would need to follow in implementing a "donut and hole" review, if it chose to adopt such a policy. Specifically, the Rural Associations recommended that this process should only be initiated by the petition of a competitor establishing that (a) it is a state-certified carrier or ETC (to ensure some minimum level of service quality); (b) it can deliver, as of the date of the filing of the petition, both broadband (as defined by the Commission for support) *and* quality voice services to at least 95 percent of the households in the specific area through use of its own facilities (or in combination with the resale of another carrier's services) and in a manner comparable to the relevant high-cost support recipient (*i.e.*, fixed or mobile service, as applicable); (c) it offers each of those broadband and voice services on a stand-alone basis at rates that are reasonably comparable to those offered by the ILEC or mobile provider, as applicable (to ensure affordability of rates for consumers); and (d) it neither receives high-cost support of any kind <u>*nor*</u> cross-subsidizes its operations in the specific, affected census block. *Id.* at 52-53. The ILEC or other high-cost support recipient should also be provided with a reasonable and meaningful opportunity to evaluate the claims made in any petition, and to present evidence refuting any of the facts averred therein. *Id.* at 54.

states and the industry to guess at where the CAF might be headed (or where competition might be present) and redraw study areas in anticipation of "moving targets."[83]

If the Commission proceeds to implement a "donut and hole" concept, as discussed in the Rural Associations' initial comments, it must clearly define the consequences of a finding of "unsubsidized competition" within a given area. Specifically, the Commission must address whether the existing high-cost support recipient would lose all support in the competitive area or only a portion of that support. If it will lose *all* support in the competitive area, then the support recipient must be permitted: (a) to disaggregate its costs and re-calibrate support for the other areas it serves – even though this will almost certainly lead to an *increased* need for high-cost support as described above; and (b) to obtain a complete release, notwithstanding any inconsistent state obligations, from any and all regulatory obligations associated with serving as an incumbent and COLR in the competitive area.[84] The Commission would also need to define with precision what level of high-cost support would remain available to the extent it cannot pre-empt the states from requiring compliance with existing COLR obligations[85] and/or where the ILEC or other support recipient otherwise continues to serve as the COLR for customers in the competitive area.

[83] *Accord* GVNW at 29.

[84] *See* NPRM ¶ 391.

[85] The assistance and input of the states in this process is critical. It would seem particularly hard for the Commission to claim on the one hand that it values the states as significant partners in this process, while then seeking to preempt them from enforcing COLR requirements that they believe benefit their consumers. Indeed, the Act makes clear that the Commission cannot proceed with any effort to target support or otherwise redefine the areas for which support is provided without the states' "buy-in." Specifically, section 214(e) confirms that designation of the service areas for ETCs is reserved for the state commissions. 47 U.S.C. § 214(e). It is therefore essential to find a path forward with respect to the redrawing of study areas based upon a competitive presence, along with its impact on COLR obligations, that is acceptable in all respects to the state commissions and the consumers they serve.

Finally, if the Commission is determined to proceed with a "donut and hole" approach, any reductions or eliminations of support must not affect the ability of RLECs to recover existing investments made under current rules. Any elimination or reduction of funding that is being used to recover the cost of existing investment in a "donut hole" would violate the core statutory principles that require high-cost USF support to be specific, predictable and sufficient, and would potentially constitute an unlawful taking of property.

E. Reverse Auctions Remain An Ambiguous And Unworkable Methodology for Determining High-Cost Support Recipients and Amounts; the Commission Should Proceed With Extreme Caution If It Is Determined To Test Such A Mechanism.

The record in the initial comments confirms that the precise manner in which reverse auctions might work remains murky, at best. In addition, even if the confusion surrounding their operation could be clarified, reverse auctions are neither a proven nor an effective method for the disbursement of funding to support the deployment and operation of broadband networks in rural areas.[86]

As an initial matter, there continues to be substantial confusion and ambiguity as to how a reverse auction mechanism would work and precisely what form it would take. For example, a significant portion of the time during the panel discussion on auctions at the Commission's April

[86] Rural Cellular Association at 17 ("Congress did not authorize FCC to employ reverse auctions to distribute USF support"); US Cellular at 29 (reverse auctions are "untested" and would "provide incentives for anti-competitive conduct"); Cox at 7-8 ("funding process should be built around standard competitive bidding, similar to the process used for most government contracts"); ICORE at 14 ("lowest bidders, will very likely try to keep their investments and service quality at bare minimums"); MoSTCG at 5 ("auctions would contradict the Act's goals of providing predictable, specific, and sufficient USF support"); LTA at 7 ("encourage a 'race to the bottom'"); Docomo Pacific, Choice Communications and AST Telecom at 11 (make it difficult for any CAF support to find its way to rural and insular areas); GVNW at 22 ("encourage the inclusion of a rural incumbent carrier exemption in any approach to reverse auctions"); Alexicon at 38-41 ("not a viable option"); CoBank at 7; MTPS at 2.

27, 2011 universal service reform workshop was spent with Commission staff and the panelists talking at a high level about the ways in which an auction might be structured, rather than discussing the precise mechanics of such a mechanism.[87] Indeed, as much (if not more) time appeared to be spent trying to clarify the proposal(s) under consideration in the NPRM as was spent debating the merits or shortcomings of any given proposal.

This lack of clarity and precision is highlighted in the comments. Comcast, for example, baldly urges the Commission to "award support with a well-designed reverse auction."[88] But if a single lesson can be drawn from the thousands of pages of comments submitted in numerous proceedings over the past several years involving potential use of reverse auctions, it is that no party has been able to offer an example of a fail-safe reverse auction mechanism, nor has anyone offered an example of a reverse auction mechanism that has successfully been put into use anywhere in the world in a situation similar to the one currently under consideration. Indeed, the question of what constitutes a "well-designed" auction mechanism has long gone (and continues to go) unanswered. As Texas Statewide Telephone Cooperative, Inc. correctly points out, reverse auctions are "theory at best," and are "not proven to satisfy the Commission's broadband objective."[89]

Furthermore it is unclear whether the Commission has the statutory authority to adopt a reverse auction mechanism for the purpose of determining high-cost support recipients. United States Cellular Corporation, for example, observes that use of a single-winner reverse auction would "turn the ETC designation process into a nullity," as it would effectively "cancel[ ] out the

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[87] Video available at http://www.fcc.gov/event/intercarrier-compensationuniversal-service-fund-reform-workshop.

[88] Comcast at 16.

[89] Texas Statewide Telephone Cooperative at 11.

state commission's Section 214(e)(2) authority."[90] Specifically, section 214(e)(2) does not enable a service provider to self-designate the area for which high-cost support will be received; that designation is solely within the province of the relevant state commission. There is also the added complexity that no additional ETCs may be designated by a state commission for an area served by a *rural telephone company* without a finding first that such designation is in the public interest[91] – and it is highly questionable whether state commissions will make such findings in the context of self-defined service areas obtained by virtue of reverse auctions.

Beyond these many substantial lingering questions about *how* a reverse auction mechanism might operate, and concerns about the legality of such an approach, there are also many lingering concerns about *whether* reverse auctions can work to effectively and efficiently achieve the objectives of universal service – and there is a considerable record that would indicate they cannot. Specifically, as many commenters have explained in the past, the proposed method would:

- Promote a "race to the bottom" in terms of service quality;[92]
- Put existing investments at risk and harm a carrier's ability to repay loans. Specifically, if a carrier other than the ILEC wins an auction for serving an "unserved" area, it would place at risk the ILEC's facilities for voice service in that area, as well as the ILEC's broadband facilities in nearby areas that could face subsidized competition from the auction winner's facilities placed in the "unserved" area.;[93]

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[90] US Cellular at 21-22.

[91] 47 U.S.C. § 214(e)(2).

[92] *E.g.*, Rural Associations at 76; LTA at 10; Pine Telephone System at 2-3; Texas Statewide Telephone Cooperative at 11; TCA at 9; Cascade Utilities at 2-3; GVNW at 21; MoSTCG at 5.

[93] *E.g.,* CoBank at 7; LTA at 7-8; GVNW at 19.

- Introduce inefficiencies in the system by undermining previously-spent universal service funds that have been used to support the deployment and operation of multi-use, broadband-capable networks;[94] and

- Fail to recognize edge-out strategies that are allowing carriers to steadily decrease the number of "unserved" areas by deploying broadband further into their sparsely populated serving areas.[95]

Comments filed in response to the NPRM reiterate these concerns and provide additional reasons why the Commission should proceed cautiously, if at all, with implementing reverse auctions for high-cost support. The Commission should be particularly mindful of comments filed in this regard by the State Members, who point out that the structure of proposed auctions are likely to cause some areas to remain unserved[96] and may prevent smaller service providers from submitting bids at all.[97] The State Members also suggest that bids received under the proposed auction structures may not be as cost-effective as the Commission apparently anticipates due to a variety of factors, including uncertainty about future debt costs, adoption rates, and for wireless providers, signal propagation.[98] These factors will likely motivate bidders to add risk premiums to bids, or simply refrain from bidding at all.[99] The State Members also

[94] *E.g.,* ICORE at 13. *See also* NTCA Initial Comments, WC Docket No. 05-337 (Apr. 17, 2008) at 8-9.

[95] *E.g.*, GVNW at 18; ICORE at 14.

[96] State Members at 78-79. Auction constraints include maximum bids, requirements that winning bidders commit to long-term POLR duties, large overhead costs required to prepare bids for small auction areas, and possible service quality problems if the ILEC does not win the auction, but is still expected to provide services to the winning bidder. *See also* NASUCA at 47.

[97] State Members at 78. *See also* Rural Associations at 78-79.

[98] State Members at 82.

[99] *Id*.

oppose allowing bidders to define their own service areas, as this self-selection would likely result in few, if any, bids for the highest-cost portions of unserved areas.[100]

In short, the initial comments filed in this proceeding make clear that proponents of reverse auctions offer little specificity in terms of how such auctions would actually work and offer little data to support the use of reverse auctions for the disbursement of high-cost universal service funding. Given the significance that this Commission places on quantitative data and specific proposals, this should be a fatal blow to reverse auctions – in effect, the Commission, the industry and its customers are being asked to undertake a substantial leap of faith and bet our nation's broadband future on a theory that has never been tested or even adequately defined.

Given the critical importance of broadband service to economic competitiveness and overall quality of life, coupled with the fact that many carriers have already made substantial inroads toward bringing affordable broadband service to the more rural parts of the country (and rely upon continuing support to maintain it), the Commission should not undermine that ongoing effort by rolling the dice on something as risky as reverse auctions. Of particular import, RLECs are the only entities that have made significant commitments and deployed facilities to serve many of the nation's most remote areas, and they have been pursuing responsible but robust "edge-out" strategies to provide broadband to those areas over time. In light of this progress and the fact that RLECs serve as COLRs *throughout* some of hardest-to-serve reaches of the country, the Commission should proceed with extreme caution in these study areas in particular and avoid impeding the significant broadband deployment momentum that these carriers have established over the course of the past several years. The best way to deploy broadband in unserved areas is

[100] *Id*. at 84-85. The State Members also point out that relying on bidders to define service areas raises significant legal questions under the Act. *See id.* at 87. *See also* NASUCA at 63.

to take what has worked and recalibrate it as needed to support the new objective, rather than "throwing all the cards up in the air" and hoping they land in a neat and organized manner.

F. The Commission Should Firmly Reject Proposals to Require RLECs to Convert to Incentive Regulation.

Although the NPRM pointedly does *not* adopt the NBP's earlier suggestion to eliminate RoR regulation in favor of mandatory incentive regulation, Verizon nevertheless continues to argue in favor of this proposal, asserting RLECs can safely be required to convert to incentive regulation without harming universal service.[101] The record shows, however, that supposed advantages of mandatory incentive regulation (*i.e.*, lower demands on the USF, lower costs of regulatory compliance, increased operational efficiencies and enhanced competition)[102] are not supported by any evidence. And proponents of mandatory incentive regulation do not even claim (never mind, show how) this action would accomplish any of the Commission's broadband goals, such as extending service to unserved areas, upgrading broadband facilities and services in rural areas, making rates affordable for rural consumers, or encouraging rural broadband adoption. By increasing regulatory uncertainty regarding future cost recovery, proposals to abandon RoR regulation have the unfortunate effect of impeding RLECs' access to capital and thus undermining the NBP's goals. The Commission should accordingly make clear in this proceeding that it will not pursue the NBP's recommendation in this regard.

Existing RoR regulation, coupled with high-cost support based on actual costs, has permitted RLECs with minimal financial resources and no access to major capital markets to deploy broadband facilities and services (generally, at speeds from 768 kbps to 3 Mbps) to over 90 percent of their customers. In contrast, carriers operating under price cap regulation

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[101] Verizon at 53-54.

[102] *Id.* at 54.

generally have a much poorer record of deploying broadband in their rural territories, notwithstanding their much greater financial resources and economies of scale, and not to mention much higher interstate rates of return on their existing investments.[103]

As the records of this Commission and state commissions demonstrate, RLECs serve the rural areas that the former Bell System and the larger independent telephone companies did not want to serve, and that the current price cap carriers or their predecessors either refused to serve *ab initio* or later sold to smaller carriers.[104] RLEC service areas (which make up over one-third of the land area of the United States) are generally more rugged, more remote, more sparsely populated, and more expensive to serve than the rural service areas of the large and mid-sized price cap carriers. RLECs also have only a small fraction of the revenues, assets, profits, cash flows and economies of scale of the Regional Bell Operating Companies ("RBOCs") and mid-sized price-cap carriers.[105]

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[103] While RLEC rates and revenue requirements must be targeted to an 11.25 percent interstate rate of return (and frequently have lower actual interstate rates of return, as well as lower intrastate rates of return), the weighted arithmetic mean interstate rate of return for all price cap carriers in 2007 (the last year that AT&T, Verizon and Qwest were required to file FCC Form 492A Rate of Return Monitoring Reports) was 30.65 percent. Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telephone Service* (Sept. 2010) at Table 4.1. In 2007, 22 of the 23 reporting Verizon price cap telephone companies had interstate rates of return ranging from 19.89 percent to 85.67 percent (the 23rd, a Verizon Northwest, Inc. entity serving the West Coast of California, had a negative interstate rate of return of 7.20 percent). *Id*. 2007 interstate rates of return for the other two RBOCs were: (a) AT&T: a range from 24.54 percent to 62.43 percent for six reporting operating entities; and (b) Qwest: 52.56 percent. Reported interstate rates of return for mid-size carriers in 2007 and 2008 were similarly high, ranging from the mid-teens to 60 or 70 percent in some cases. *Id. See also* GVNW at 32-33.

[104] For example, as recently as 2008, Verizon sold most of its rural Maine, New Hampshire and Vermont exchanges to FairPoint Communications, Inc. *See* Karl Bode, *Verizon Sells Huge Chunk of Network to Frontier*, DSL Reports (May 13, 2009) (available at http://www.dslreports.com/shownews/Verizon-Sells-Huge-Chunk-Of-Network-To-Frontier-102414).

[105] For example, Verizon's operating revenues ($106.565 billion for 2010, $107.808 billion for 2009 and $97.354 billion for 2008), net income ($10.217 billion for 2010, $11.601 billion for 2009 and $3.962 billion for 2008), total assets ($220.005 billion at the end of 2010 and $226.907

Unlike larger carriers, most RLECs are not able to list and trade their stock and bonds on the New York Stock Exchange or other international, national or regional stock exchanges, borrow from Wall Street and other large banks, or otherwise access the resources of international, national and regional capital markets. Rather, RLECs generally have very limited financing options – primarily the RUS and (if and when the overall economy improves and the current uncertainties regarding future high-cost support and access revenue streams are resolved), CoBank, the Rural Telephone Finance Cooperative ("RTFC"), and a few small local banks.

Notwithstanding these major disadvantages, RLECs have been successful in deploying broadband services to their rural customers. In its November 2007 *Recommended Decision*, the Joint Board declared that RLECs had done a "commendable job" under the existing high-cost USF mechanisms of deploying voice and broadband services to nearly all of their customers while continuing to meet COLR responsibilities.[106]

A primary success factor in such hard-to-serve areas consists of the incentives created by local presence, local ownership and/or local management. For the substantial majority of RLECs, the provision of service to their rural exchanges is now, and has long been, their sole or predominant business. Many cooperatives and other locally-owned RLECs were established to serve their owners, their directors, their managers, and their employees, as well as neighbors,

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billion at the end of 2009) and cash and cash equivalent assets ($6.668 billion at the end of 2010 and $2.009 billion at the end of 2009) dwarf the financial resources of even the larger RLEC holding companies (those with over 100,000 loops), much less the typical RLEC. *See* Verizon Communications 2010 Annual Report, at 13 (available at http://www22.verizon.com/investor/investor-consump/groups/public/documents/investorrelation/2010_annualreport_quicklinks.pdf)

[106] *High-Cost Universal Service Support*, WC Docket No. 06-337, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477 (2007) ¶¶ 30, 39.

friends and acquaintances. RLECs want and need to provide high quality broadband and voice services at affordable rates to their rural customers because they know their customers personally, and have local reputations and personal relationships to maintain.

While some may wish that existing RLECs could be merged into a handful of regional holding companies, this is unrealistic and would not serve the public interest. In addition to eliminating jobs that are critical to the economic life and health of many rural communities,[107] RLEC consolidation would be likely to result in the loss or degradation of broadband and voice service in many rural communities.[108] Given that RLECs have personal and localized incentives to serve their rural customers, the synergies of RoR regulation, high-cost USF support and access revenues have provided them with the resources necessary to invest in the infrastructure to provide the desired quality communications services at affordable rates. The stability and certainties of RoR regulation, together with reliable USF and access revenue streams, have enabled RLECs to furnish their investors and lenders with the assurances of cost recovery and loan repayment that are essential for these small companies to obtain financing for infrastructure investments.

The solution to alleged "rural/rural divide" concerns is not to punish RLECs for their effective efforts by implementing drastic reforms, or to reward those larger carriers with greater resources who have not found it within their business plans or stockholders' interests to invest in areas where the addressable market is small. Nor is the solution to dismantle RoR regulation and redistribute or otherwise reduce high-cost USF support and access revenues. As demonstrated

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[107] Many RLECs filed employment data in their comments in this proceeding. *E.g.,* Alexicon at 42; TDS at 6; Fred Williamson & Associates at 13.

[108] It is also unclear where financing for such a "roll-up" would come from, and whether the cash flows from businesses that often operate in remote geographic locations would be adequate to service the acquisition debt even if financing could be found.

throughout the record in this proceeding, today's rural broadband-capable networks depend upon this support; to withdraw it as proposed would imperil the broadband access enjoyed today by many rural Americans.

Moreover, most RLECs still need to make substantial further investments and upgrades to reach the 4 Mbps download/1 Mbps upload broadband availability target advocated in the NBP and NPRM, much less to offer the significantly greater bandwidths and speeds that are already being demanded today by customers to accommodate the ever-growing number of bandwidth-intensive applications and services. As more rural residents and businesses use broadband service to participate and compete in regional, national and international markets, "reasonably comparable" broadband bandwidths and speeds will morph into *absolutely essential* broadband bandwidths and speeds, if these Americans are to be able to function successfully in the global economy.

The combination of RoR regulation with high-cost support based upon actual costs has been extremely successful in bringing broadband services and related innovations to rural areas. Since the record provides no basis for replacing RoR regulation with mandatory incentive regulation for RLECs, and much evidence against, the Commission should firmly reject this approach. Instead, the RLEC Plan ensures that the best aspects of what has worked in RLEC markets is retained, while also leaving sufficient "headroom" for support that could perhaps finally prompt larger carriers (or perhaps others willing to step in) to deliver on the promise of broadband for the smallest of their markets.

IV. THE RECORD SUPPORTS A MEASURED APPROACH TO ICC REFORM FOR RLECS THAT ENABLES THESE CARRIERS TO CONTINUE OFFERING HIGH-QUALITY, AFFORDABLE BROADBAND IN HIGH-COST AREAS.

The record in this proceeding supports the conclusion that while the existing ICC regime should be reformed to reflect today's competitive marketplace and the evolution to all-IP networks, reform must not inadvertently harm rural consumers by causing abrupt increases in local service rates and thwarting RLECs' ability to continue upgrading and expanding their broadband service offerings. The measured and sensible approach to ICC reform contained in the RLEC Plan would achieve these dual objectives.

A. Commenters Agree Any Reduction In RLEC ICC Rates Must Be Coupled With A Sufficient Restructure Mechanism.

Like the Rural Associations, other commenters also recognize that a sufficient RM must accompany any reduction of RLECs' ICC rates that takes place as part of ICC reform.[109] This is critical to ensuring that ICC reform does not harm rural consumers or prevent RLECs from meeting the universal broadband goals contained in the NBP and the NPRM. As one commenter notes, without a sufficient RM:

> rural carriers would be unable to continue the transition to a more ubiquitous broadband network in the highest cost to serve areas of the country, and customers of these carriers [would] face the potential for very significant increases to local rates or SLCs that would not meet the comparable rate standard found in Section 254.[110]

In addition, the primary purpose of the instant proceeding is to transition the high-cost universal service program from its present voice-service focus to a program focused on

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[109] TDS at 18-19; GVNW at 23; JSI at 18; Rural Broadband Alliance at 17; MoSTCG at 8; ICORE at 22-23; XO at 46-48; Michigan PSC at 18; CWA at 11, 21.

[110] GVNW at 23.

providing affordable broadband services in high-cost rural areas of the nation.[111] The revenues that RLECs presently receive from ICC are essential for continued broadband network investment and affordable broadband end-user rates in these areas. Put another way, ICC is a linchpin, rather than an impediment, to a broadband transition in rural America. To revoke ICC revenues altogether or reduce them materially before this transition is complete would ignore marketplace realities in favor of a distant "end game" that may never come to pass if the transition is mishandled.[112] Thus, an RM that allows RLECs to fully recover the revenues lost from mandated ICC rate reductions, coupled with a "reasonably comparable" local voice-service rate benchmark, is entirely consistent with the purpose of a "transformed" high-cost USF program.

A few commenters assert that the Commission should consider RLECs' revenues from both regulated and non-regulated services for the purpose of determining carriers' RM funding amounts.[113] As the Rural Associations noted in initial comments and as discussed above, it has long been Commission policy that RLECs' regulated and non-regulated costs and revenues be kept separate.[114] Moreover, as discussed above, should the Commission decide to abandon this

[111] NPRM ¶¶ 18, 157.

[112] This once again is why a sensible decision with respect to VoIP traffic is so critical. Putting VoIP on a distinct track for reform or subjecting it to a distinct rate (or no rate at all) will render utterly meaningless whatever sensible ICC reform transition the Commission may otherwise decide to put into place. If VoIP is singled out for preferential treatment in any way, the Commission will have just enabled every self-serving carrier or provider to sidestep a well-planned transition by declaring its traffic to be "VoIP" and then daring the terminating carrier to prove that claim wrong. Tying carriers up in resulting disputes or litigation – or undercutting cash flows altogether by putting VoIP on a unique pedestal – will do nothing to advance the cause of broadband deployment; it will only distract and delay carriers who would rather be building broadband-capable networks.

[113] Time Warner at 13; Missouri PSC at 23; AdHoc Telecommunications Users Committee at 51-54.

[114] Rural Associations at 18-19.

long-standing policy, it should not ignore the *costs* RLECs incur in generating revenues from non-regulated services. As the Blooston Rural Carriers point out, "[m]any rural ILECs barely break even on the sale of certain non-regulated services, such as video programming,"[115] More critical, however, the Commission would be walking into the legal and practical quagmire of attempting to define those unregulated costs and services that should be included in the calculation from those that should not, as discussed previously in these comments. It would, therefore, be inappropriate to consider revenues derived from the provision of non-regulated services in the calculation of an RLEC's distribution from the RM.

The Commission should also reject calls for an artificial time limit on the duration of the RM for RLECs.[116] It is certainly true that an RM will have the effect of providing "[RLECs] sufficient time to adjust their business models…."[117] More important, however, rural consumers must be the ultimate beneficiaries of ICC reform for RLECs. It would be imprudent to adopt an arbitrary cut-off date for the RLEC RM at this time before the Commission has even had an opportunity to evaluate the impact of initial access rate reductions on both carriers and rural subscribers.[118] This is one reason again that the RLEC Plan has "pause points" built within it. These points enable the Commission to make informed decisions about further steps of reform without putting into place arbitrary measures based upon guesswork as to what the world will look like five or ten years in the future.

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[115] Blooston Rural Carriers at 18.

[116] Time Warner at 9 (stating that the duration of an RM should be limited to a maximum of three years).

[117] CTIA at 42.

[118] Under the RLEC Plan, the first stage of ICC reform for RLECs would entail the lowering of intrastate switched access rates to interstate rate levels, at the direction of state commissions. Rates for other traffic would be examined in a further stage of this proceeding, in three to five years.

Finally, a few commenters state that carriers should first look to their end users to offset lost ICC revenues that result from ICC reform.[119] This is precisely the approach contained in the RLEC Plan, which acknowledges that it is entirely appropriate for RLECs with below-average local voice service rates to look first to their end users to recover a portion of their lost intrastate access revenues. Specifically, the RLEC Plan proposes a $25 local voice service rate benchmark that is likely to result in rate increases for many RLEC subscribers, yet at the same time it avoids making basic voice service unaffordable or not "reasonably comparable" with urban rates. This equitably balances the needs of rural consumers with the need to keep the size of the RM manageable.[120] The RM also appropriately recognizes that, unlike others who may operate in any given market with much greater flexibility (and thus capability to manage end user cost recovery), RLECs bear the unique obligation of serving as COLRs, meaning that they cannot simply deny the provision of service to a customer whose cost of service is too high or unilaterally decide to increase or reduce rates for individual customers to make up ICC shortfalls.

B. The Record Confirms The Commission Does Not Have The Legal Authority To Bring All Telecommunications Traffic Within The Reciprocal Compensation Framework of Section 251(b)(5).

Commenters flatly reject the NPRM's proposal to bring all telecommunications traffic within the reciprocal compensation framework of section 251(b)(5), including intrastate access rates.[121] As NARUC explains, "section 152 operates in tandem with other sections of the 1996

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[119] Level 3 Communications at 9; COMPTEL at 36.

[120] Under the RLEC Plan, a $25 benchmark would reduce the initial size of the RLEC portion of the RM by more than 40 percent, from approximately $367 million (if the RM were based solely on reducing intrastate access rates to interstate levels, without a benchmark) to $215 million.

[121] *E.g.,* Nebraska PSC at 27; RCA at 29-30; Kansas Corporation Commission at 38-39; California PUC at 19-20; Michigan PSC at 17; New York PSC at 7-13; Massachusetts Department of Telecommunications and Cable at 18-21; Utah Rural Telecom Association at 6-7; Washington UTC at 12-13; Indiana URC at 11.

legislation to <u>mandate</u> reservation of continuing state authority to 'establish access and interconnection obligations of local exchange carriers.'"[122]

Reliance on section 251(g) seems similarly misplaced. As the State Members point out, section 251(g) "was intended to maintain the pre [1996 Act] status quo regarding interconnection arrangements and existing intercarrier compensation rates, not to supply the FCC with an additional or new legal authority capable of preempting traditional State jurisdiction under Section 152(b)."[123] By "invit[ing] legal challenge and [causing] the Commission's reform efforts to languish in litigation"[124] the proposed section 251(b)(5) and/or 251(g) approach will only delay needed reforms and create further instability in existing ICC rates and rules. The Commission should instead focus "on areas that the courts have made clear are within the Commission's jurisdiction to minimize the risk of litigation and disputes, providing greater stability regarding the reform."[125]

Apparently recognizing the legal infirmities associated with use of section 251(b)(5) to override state authority over intrastate rates, Verizon argues the Commission has authority to adopt a single, default rate for all traffic routed on the PSTN under sections 201 and 332 of the

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[122] NARUC at 12 (emphasis in the original) (citing section 251(d)(3), which states that: In prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that— (A) establishes access and interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.). *See also* Reg. Comm. of Alaska at 30; State Members at 144.

[123] State Members at 143. *See also*, New York State Public Service Commission at 12 ("Section 251(g) merely provides for the continued enforcement of certain pre-Act regulatory interconnection restrictions and obligations. It clearly is not an independent grant of authority to establish pricing standards over intrastate traffic. Thus, it does not override the §152(b) bar against FCC assertion of jurisdiction over intrastate traffic.").

[124] Utah Rural Telecom Association at 6-7.

[125] NPRM ¶ 537.

Act, supposedly because changes in the marketplace are making it increasingly difficult to jurisdictionalize traffic.[126]

But such general assertions concerning "trends" in telecommunications services do not provide a solid basis to override the strict jurisdictional limitations of section 2(b) of the Act. The Commission may only preempt state commissions with respect to regulation of intrastate matters if it is *not possible* to separate intrastate and interstate components of such services.[127] If the Commission is going to preempt state jurisdiction over a significant aspect of intrastate telecommunications pursuant to this standard, it needs a strong quantitative basis to conclude that the interstate and intrastate components are in fact inseparable. Generalized observations to that effect are simply not sufficient. And just because it may be difficult to establish the jurisdiction of *some traffic* (at times because of the gaming of those carriers attempting to disguise it), this does not mean the Commission can or should assume jurisdiction and preempt the state commissions' rate-setting authority with respect to *all traffic*. Such preemption would be markedly different from -- and vastly overreaching when compared to -- the Commission's action in the *Vonage* preemption matter upon which Verizon principally relies.

In that matter, the Commission determined there was "no practical way" to sever certain forms of Voice over Internet Protocol ("VoIP") calling into interstate and intrastate communications because the service enabled a nomadic presence.[128] Here, the Commission is asked to preempt state commission jurisdiction over intercarrier compensation for *every call that traverses the PSTN* -- even those calls for which jurisdiction easily can be determined – simply

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[126] Verizon at 23-41.

[127] *North Carolina Utils. Comm'n* v. FCC, 552 F.2d 1036 (4th Cir. 1977).

[128] *Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, WC Docket No. 03-211, Memorandum Opinion and Order, 19 FCC Rcd 22404 (2004) ¶ 31.

because Verizon asserts it is difficult to determine the jurisdiction of some unspecified percentage of calls and because services that enable such calls may be gaining market share.

Today, however, carriers remain fully capable of establishing the jurisdiction of the vast majority of access traffic, even if that task might be made more difficult by the emergence of new services and technologies over time and/or the actions of third parties who attempt to disguise the nature of the traffic they transmit to other networks. Predictions regarding future service trends provide no evidentiary or legal basis for the Commission to undertake the dramatic action of overriding section 2(b) of the Act to preempt state commissions' rate-setting authority with respect to intrastate access charges.

It should be noted that the RLEC Plan makes such legally untenable approaches to ICC reform entirely unnecessary. This is because the Plan contains a strong incentive for states, on their own accord, to direct RLECs to lower their switched intrastate access rates. More specifically, if a state commission or legislature[129] directs the RLECs in its state to reduce their intrastate switched access rates to interstate levels (as a number have already done), RLECs in that state would be eligible to receive incremental federal RM funding from the CAF, provided their local voice service rates align with a local voice service benchmark rate of $25 per line per month.[130] The Commission should therefore adopt a transition path for ICC reform for RLECs based on today's jurisdictional framework and the RLEC Plan submitted by the Associations.

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[129] As the NPRM notes, some state commissions lack authority over intrastate access rates. NPRM ¶ 547. The RLEC Plan may incent state legislatures to grant that authority or begin the process of intrastate access rate reductions on their own.

[130] The RM funding an RLEC would receive under the RLEC Plan would be equal to the shortfall from mirroring interstate traffic sensitive switched access rates, plus any lost intrastate Carrier Common Line ("CCL") revenues.

C. The Record Does Not Support Adoption of a Mandatory Bill-and-Keep ICC Regime or Any Other Artificially Low Uniform Rate for RLECs.

Commenters generally oppose proposals for a mandatory bill-and-keep ICC regime,[131] or an artificially low uniform rate, such as $0.0007 per minute-of-use.[132] To begin with, if RLECs were forced to charge other carriers little or nothing for their use of RLEC networks, those lost revenues would need to be recovered directly from RLECs' limited end-user customer base, placing significant upward pressure on end-user rates for voice and broadband service,[133] or would unnecessarily drive up the size of any RM. On the other hand, if RLECs were unable to raise local rates due to regulation or competition, as the State Members point out, carriers would be forced to "dramatically lower their costs, which could jeopardize the capital resources needed to build broadband networks."[134] Either way, the outcome is inconsistent with the universal service principles contained in section 254 of the Act and the Commission's own goals for this proceeding.

A few commenters assert that a bill-and-keep regime is necessary to eliminate the arbitrage occurring under the existing ICC system.[135] However, as the Rural Associations noted

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[131] TSTCI at 23, GVNW at 24, Reg. Comm. of Alaska at 25-26, State Members at 149; GVNW at 24; GCI at 42; ITTA at 40-42; Iowa Telecommunications Association at 5; JSI at 17; MoSTCG at 8.

[132] As the MoSTCG states, "the artificially designed $0.0007 rate would not cover the MoSTCG companies' costs of billing for the traffic, much less any reasonable costs for the use of their networks." MoSTCG at 8. *See also* Frontier at 9. The Commission should dismiss Verizon's claim that a $0.0007 ICC rate is appropriate for all carriers, including RLECs, because it is "already the rate at which a substantial amount of traffic is currently exchanged…." Verizon at 10. ICC rates charged by providers operating in urban and suburban areas of the nation are entirely irrelevant to the unique circumstances faced by RLECs providing service in sparsely populated high-cost rural areas.

[133] TSTCI at 23; GVNW at 24; Reg. Comm. of Alaska at 25-26. *See supra* pp. 7-8.

[134] State Members at 149.

[135] *E.g.,* CTIA at 37; T-Mobile at 4.

in comments on section XV of the NPRM,[136] certain short-term reforms, such as affirming the applicability of existing ICC rules and rates to interconnected VoIP providers,[137] strengthening the call signaling rules to address phantom traffic,[138] and measured steps to discourage access stimulation,[139] will go a long way toward eliminating the arbitrage that has been occurring. Additionally, the RLEC Plan proposes to encourage state commissions to authorize the reduction of RLECs' switched intrastate access rates to interstate levels, as an initial first step, which will also eliminate another source of arbitrage.

Far from eliminating arbitrage, a bill-and-keep ICC regime would produce "new arbitrage schemes…because a single party would have the ability to send large amounts of traffic to another party—thereby causing the receiving party to incur costs and obligations for which the sending party bears no responsibility."[140] Indeed, a bill-and-keep system would lead IXCs, wireless providers, VoIP providers, and others to dump their traffic on carriers' "free" facilities,

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[136] Comments of NECA, NTCA, OPASTCO, WTA, ERTA, The Rural Alliance, and The Rural Broadband Alliance, WC Docket No. 10-90 (filed Apr. 1, 2011) (*Rural Associations' Section XV Comments*).

[137] More specifically, the Commission should immediately confirm that under existing law, traffic originating from or terminating to interconnected VoIP services is subject to the same intercarrier compensation rates – including access charge obligations – as any other traffic originating from or terminating to the PSTN. *Id.* at 4-16.

[138] The Commission should adopt rule revisions applying call signaling requirements, including mechanisms adequate to avoid fraud and ensure compliance with such requirements, to all forms of traffic originating or terminating on the PSTN and to all interconnected service providers, regardless of jurisdiction or technology. *Id.* at 16-30.

[139] To address access stimulation in a targeted manner, the Commission should adopt reasonable rules to address access rate development and allowed levels of earnings in access stimulation situations. *Id.* at 30-37.

[140] Verizon at 14. *See also* MoSTCG at 6-7 (stating that, "[o]n the other hand, eliminating intercarrier compensation would send a distorted price signal (*i.e.* carriers may use rural networks for free)").

requiring them to invest in additional capacity to prevent network congestion.[141] Of course, without the revenue that ICC charges have traditionally provided to help pay for the cost of maintaining and operating high-cost rural networks, such expansion may not be financially feasible.

In addition, the record confirms the Commission does not have the legal authority under the Communications Act to adopt a mandatory bill-and-keep regime. As the Public Utilities Commission of Ohio correctly points out, "a bill-and-keep arrangement is, in fact, a rate setting process. As the FCC is well aware, responsibility for establishing rates is reserved to the states under the Act."[142] In other words, while the Commission may refer to bill-and-keep as an ICC methodology, it is in fact the establishment of a "zero rate" and, as such, may not be mandated by the Commission. Moreover, not a single party advocating a bill-and-keep methodology explains how a zero rate meets the "additional cost" standard in section 252(d)(2)(A), nor how a mandatory bill-and-keep regime avoids the constitutional mandate against a "takings" of private property.

Finally, proponents of a bill-and-keep regime or an unreasonably low uniform rate make much of the notion that the existing ICC system has hindered the transition to all-IP networks.[143]

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[141] Verizon at 15; Rural Associations at 24; TSTCI at 23 ("Placing a value of "zero" on the local networks seems illogical and creates new arbitrage opportunities while having the perverse impact of increasing the capital investments of the ILECs.").

[142] Ohio PUC at 46. *See also* COMPTEL at 34 ("The Supreme Court has interpreted the statute to mean that while the Commission has jurisdiction to establish a pricing methodology, it is the states that must apply the pricing standards of Section 252(d)(2) and implement the Commission's methodology to set actual rates. *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 384-385 (1999). Bill and keep is not a pricing methodology. It is a transport and termination rate of $0, which the Commission is without authority to impose on carriers under the Telecommunications Act and the Commission's own rules.").

[143] Sprint Nextel at 4; CTIA at 35; MetroPCS at 15. These claims mimic similar assertions included in the NPRM. NPRM ¶¶ 495, 506, 527. In response, the Blooston Rural Carriers state that "[i]n support of its position, the Commission cites to the [NBP] and comments filed by

However, as NASUCA points out, this argument is "belied by the fact that the smaller carriers have deployed broadband networks more consistently than the large carriers."[144] Ironically, rather than today's ICC regime preventing the evolution of RLEC networks to all-IP, it is actually the ICC and USF proposals contained in the NPRM that would have this very effect. Frontier Communications accurately states that "[t]he transition to soft switches is happening organically as switches are replaced, but the Commission cannot expect carriers to bear the capital expenses involved with such a transition, while at the same time the Commission is eliminating support to these same carriers."[145]

Like the Rural Associations, other commenters acknowledge that when networks become entirely IP-based, an ICC regime based on minutes of use may no longer be appropriate or desirable.[146] Flat-rate arrangements, such as those based on capacity for example, should be explored.[147] Regardless of the compensation methodology the Commission ultimately chooses

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Sprint Nextel, Cablevision and Paetec in connection with NBP Public Notice #25. These comments, however, constitute unsupported and self-serving allegations that certain unidentified 'ILECs' refuse to upgrade to IP-based systems and provide IP interconnection. Further, it appears that these allegations arose, at least in part, out of disputes with local exchange carriers over the legal interpretation of Section 251 of the Act." Blooston Rural Carriers at 17.

[144] NASUCA at 89. *See also* ICORE at 19 (stating that rural carriers' "investment decisions are based on sound business practices and the desire to provide subscribers with the services that they demand. Often times more pragmatic reasons influence rural ILEC investment decisions as well. In some states, state commission and/or legislatures require the deployment of broadband to all consumers in the state by a certain date. In addition, competition from a Cable Company providing high-speed internet services creates additional incentives to expand and enhance broadband networks. These regulatory and market driven forces will continue to influence the evolution of rural networks without the need for drastic changes to the current intercarrier compensation process."); Alexicon Telecommunications Consulting at 33.

[145] Frontier at 8-9.

[146] *See* Ohio PUC at 48; GVNW at 25.

[147] In comments, the Rural Associations pointed out that RLECs have made significant strides replacing older time-division multiplexing ("TDM")-based switching equipment with new IP "softswitches," and, contrary to claims, increasingly offer IP interconnection to customers. Rural Associations at n. 54. The Rural Associations also explained that the RLEC Plan contemplates

for an entirely IP-based network, that methodology must continue to recognize that a service provider's use of an RLEC's facilities still imposes costs, albeit in a different manner. But the Commission should not prejudge when that transition may occur or what exactly it will look like when it transpires. To do so is precisely the opposite of "market-driven" reform. The RLEC Plan for ICC reform will enable RLECs to continue their migration to all-IP networks while maintaining affordable and reasonably comparable rates for basic and advanced services, consistent with the purposes of this proceeding.

D. The Commission Should Not Attempt to Reform Existing Transport and Interconnection Rules Until ICC Rate Issues Are Resolved.

The Commission has a lot on its plate. It faces the prospect of reforming a High-Cost program that provides $4.5 billion per year in universal service support for high-cost areas, as well as addressing a multi-billion dollar ICC market. It must balance the need to ensure that advanced service capabilities ***become*** available in places where they are not today with the need to ensure that such services ***remain*** available and affordable in places where providers have relied on support to invest in and operate advanced networks. It must also determine how to eliminate arbitrage in the ICC regime without upsetting revenue streams that carriers depend upon to recover network investment and without providing what amounts to a "regulatory give-away" to big carriers like Verizon without any concomitant benefit to be realized by American consumers.

These are not easy balancing acts and, as described elsewhere herein and in the comments of other parties, the Commission faces many legal, jurisdictional, and practical obstacles in navigating these challenges. The Commission can simplify the tasks at hand by reforming the USF and ICC regimes first, and address potential revisions to interconnection and

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potential replacement of today's minutes-based ICC mechanisms with alternative structures designed for IP interconnection, such as a system based on "port and link" charges. *Id.* at n. 74.

transport rules at a later point. To attempt all three at the same time would effectively demand that the Commission play three-dimensional chess, trying to turn "dials" on ICC rates and "repurpose" high-cost USF support toward broadband while at the same time redefining the interconnection and transport regimes that may govern where ICC rates begin to apply.

In attempting such a maneuver, the Commission would run the substantial risk of adopting reforms that have unintended and unanticipated consequences. For example, if the Commission were to reduce unilaterally the rates for *all* transport and termination functions to $0.0007 *and* simultaneously re-define the points at which those rates would apply, there is a substantial likelihood such a "one-size-fits-all" approach to reform will create substantial disruptions for many carriers. Likewise, superimposing a mandatory IP-based interconnection obligation atop the current framework as some suggest,[148] or doing away altogether with existing network connection obligations as suggested by others,[149] could create unforeseeable distortions in the market and/or introduce unforeseen opportunities for new modes of regulatory arbitrage.

The Commission should therefore tackle reform in stages that allow it to isolate and assess the impact of certain rule changes before proceeding apace with changes to additional rules. Specifically, it should address first the question of whether and how to reform ICC rate levels, and only after the reform path for that regime is settled and "tested" in the marketplace should it turn its attention to whether there are appropriate and useful ways in which to reform the underlying interconnection and transport rules. The RLEC Plan, with built-in "pause points," offers a sound platform for such a prudent and well-managed approach. In particular, the Commission should take the first step, as recommended by the Rural Associations, to equalize intrastate switched access rates with interstate rate levels within a few years. It could then re-

[148] *E.g.,* XO at 7-16; Charter at 4-13.

[149] AT&T at 54.

evaluate three to five years thereafter the extent to which further rate reductions are required and/or whether underlying revisions to carriers' interconnection and/or transport responsibilities are needed in connection with such reform. This would allow the Commission to "get it right" on the fundamental question of ICC rate reform without being required to worry about whether the foundation upon which those rates rest is also shifting in an unsustainable or even potentially contrary manner.

V. EXISTING FUND LEVELS WILL NOT BE SUFFICIENT FOR ACCOMPLISHING THE NATIONAL BROADBAND PLAN'S GOALS.

Numerous commenters in addition to the Rural Associations[150] express strong skepticism over whether the Commission can accomplish its ambitious broadband goals without addressing contribution issues and without permitting the overall size of the High-Cost program to grow beyond its current level.[151] As one commenter notes, "the CAF as currently conceived by the Commission will be woefully inadequate to achieve the FCC's stated goals. The Commission (or Congress) should provide for a significant increase in funding to maintain and upgrade public networks."[152] Another commenter points out that pre-determined funding limits have led the Commission into a "false choice" error. That is, because funds are supposedly limited under existing contribution rules, the Commission believes it must "eliminate support from existing

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[150] *E.g.*, RTG at 24; Mississippi PSC at 12; LTA at 10-11; ITTA at 14, 20; COMPTEL at 16; CBeyond, *et al*. at 3, 17-19.

[151] Indiana URC at 9-10 ("Any attempts to control the overall size of the universal service support mechanisms must take into account the size of the low-income fund, in addition to the size of the high-cost fund today and the size of the CAF in the future.") *See also* RTG at 24 ("The current contribution methodology is not only unsustainable, but also outdated, and should be reformed to include a broader base of contributors."); Massachusetts Dept. of Telecommunications & Cable at 6, n.26.

[152] FairPoint at 23-24. *See also* US Cellular at 56-58, 78-83; Docomo Pacific, Choice Communications and AST Telecom at 18; LTA at 10-11; USA Coalition at 28-29.

providers of voice services who also provide broadband in order to support expansion of a very limited broadband service to areas now unserved."[153]

There is a fundamental inconsistency between the requirements of the Act and the Commission's insistence that the size of the High-Cost program cannot increase.[154] Once the Commission defines the broadband network and services that will be supported by federal universal service support mechanisms, it is directed by sections 254(b) and (e) to preserve *and advance* universal service via "specific, predictable, and sufficient" support mechanisms. Section 254(b)(3) goes on to state that consumers in rural and high-cost areas should have access to telecommunications and information services, including advanced services, that are reasonably comparable to those provided in urban areas and at reasonably comparable rates.[155] The law does *not* make any reference to the imposition of a cap on the size of the USF or on any of its individual programs. As CoBank points out, "[o]nly by allowing the CAF to grow as needed to support investments in rural broadband networks will the goal of ubiquitous broadband at speeds and rates reasonably equivalent to urban subscribers be achieved."[156] Another commenter explained that "Congress gave the Commission a set of goals and ordered that universal service support be sufficient to achieve them. . . . [a] reduction in the Fund would risk

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[153] RICA at 8.

[154] Rural Associations at 89.

[155] "[L]oss of traditional USF support to the existing voice service providers will lead to higher rates or the ceasing of operations (resulting in the loss of service availability), both of which would also represent a violation of Section 254(b)(3). To the extent support for the lower speeds (4 Mb/s downstream and 1 Mb/s upstream) is provided only in **rural** unserved areas, this type of action 'may well violate the spirit if not the letter of Congressional intent in 47 U.S.C. § 254(b)(3)'" Indiana URC at 2 (emphasis in original).

[156] CoBank at 5.

jeopardizing the whole point of universal service reform and the Commission's Broadband Plan."[157]

Commenters also explain why the Commission needs to expand the contribution pool to include broadband Internet access service providers so that the beneficiaries of "repurposed" support bear a fair share of the cost.[158] The State Members, for example, recommend the Commission broaden the USF contribution base to include all services that touch the "public communications network" (i.e., the "interconnected communications network that uses public rights of way or licensed frequencies for wireless communications.").[159]

At a minimum, the comments recommend the Commission apply the USF contribution obligation in a nondiscriminatory manner across all like services, e.g., all broadband services such as digital subscriber line ("DSL"), cable modems, and wireless broadband.[160] They point out the statute requires that contributions be "equitable and nondiscriminatory."[161]

The Rural Associations recognize that the funding available for supporting broadband networks and services is not unlimited. The foregoing arguments are not to say that the Commission should be unconcerned with *managing* growth in the size of the High-Cost program – to be successful, the program must be sustainable. However, the Commission must balance between its desire to minimize contribution burdens imposed on households nationwide and the need to avoid detrimental impacts on rural consumers, as well as achieving reasonable

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[157] US Cellular at 57. US Cellular also stated that capping the Phase II CAF support mechanism would undermine the achievement of universal service goals. *Id.* at 78.

[158] *E.g.*, JSI at 3; MoSTCG at 2; Rural Telecom Carriers Coalition at 18; LTA at 11; NTCH at 10; NJ BPU at 5; ITTA at 20; CBeyond, *et al.* at 19.

[159] State Members at 118.

[160] State Members also suggest the Commission examine current reporting categories defined for FCC Form 499-A. *Id.* at 119.

[161] *Id.* at 121.

comparability between rural and urban areas.[162] The Commission should establish a more level playing field and require that similar services using the same or similar technology contribute to the USF based on a consistent set of rules.

The State Members note that their staff has estimated that if all revenues currently reported on line 418 of FCC Form 499 were required to contribute to the Fund, the carrier contribution factor would be reduced to approximately 2 percent.[163] By broadening the contributor base to include all providers of broadband Internet access services and applying the contributions rules to all such providers equally, USF contributions and associated fund levels may be increased to the point where they are sufficient to accomplish the goals of the NBP, without imposing an unreasonable end-user fee on any assessable service.

VI. CONCLUSION

Comments filed in this proceeding make clear that the proposals described in the NPRM will harm, not advance, universal service. Data and analyses provided by numerous commenters illustrate clearly how, in the absence of alternative sources of support, proposed short-term revisions to existing rules will cause end user rates to increase dramatically, create substantial risk of defaults on existing loans and jeopardize future expansion of, and upgrades to, broadband services in RLEC areas. The comments also make clear that the Commission will face a host of legal and practical problems in attempting wholesale conversion of existing high-cost support mechanisms to new "market based" approaches or to impose uniform, below-cost ICC rates or a mandatory "bill and keep" methodology in place of existing cost-based ICC structures.

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[162] *See, e.g.,* USA Coalition at 28.

[163] State Members at 120.

The Rural Associations therefore continue to urge the Commission to consider reasonable alternatives to the proposals set forth in the NPRM, including specifically the RLEC Plan set forth in the Rural Associations initial comments. As discussed above, the Plan would achieve reform for these carriers in a manner that is practical and easily implementable, while remaining consistent with the Commission's reform principles and, most importantly, consistent with the provisions of the Act.

In short, the Rural Associations strongly support the Commission's objective of making affordable broadband services available to *all* Americans in as efficient and effective a manner as possible. However, it is clear that in an effort to achieve this objective, the NPRM's proposals would wind up doing great harm to the continued availability of affordable and "reasonably comparable" basic and advanced services to rural consumers in RLEC areas. Therefore, instead of betting America's broadband future on grand visions, untested schemes, and complicated, circuitous and legally-questionable premises and processes, the Rural Associations urge the Commission to pursue more straightforward, practical alternatives. The RLEC Plan represents the most reasonable pathway toward sustainable reform for RLECs, and the Rural Associations accordingly urge the Commission to begin steps to implement it as soon as possible.

Respectfully submitted,

May 23, 2011

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the Associations' Reply Comments was served this 23rd day of May, 2011 by electronic filing and e-mail to the persons listed below.

By: /s/ Elizabeth R. Newson
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