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

In the Matter of	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

REPLY COMMENTS OF UNITED STATES CELLULAR CORPORATION AND RURAL CELLULAR CORPORATION

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SUMMARY

U.S. Cellular and RCC have proposed a competitively neutral plan for long-term high-cost universal service reform that will enhance the long-term sustainability of the high-cost fund and provide direct, tangible, and significant benefits to consumers in rural America. The proposal has three components: portability, efficiency, and disaggregation. This proposal can be implemented easily, and it has, in large part, already been endorsed by the Joint Board and the Commission. Now is the time for the Joint Board and the Commission to move forward with policy decisions that will preserve and advance universal service and will continue to bring the benefits of competition to the rural marketplace.

Commenters opposing various aspects of our plan have relied upon outdated and discredited arguments that provide no basis for their objections, nor do they provide any sensible alternatives. First, by defending the modified embedded-cost methodology currently in place, rural ILECs and their supporters are intent upon retaining a cost methodology that places little restraint on spending and ensures generous returns on investment for a service consumers are using less and less. These commenters fail to acknowledge that paying rural ILECs based on efficient costs would advance network construction and upgrades using modern technology, to the benefit of consumers. Moreover, those who argue that it would be too complicated to develop an alternative mechanism for rural areas are merely making excuses and deny the importance of implementing long-overdue reform. Rather than put off essential reforms even further, we encourage the Joint Board and the Commission to take a close look at proposals by ALLTEL and others to implement a methodology for rural areas based on an efficient cost model.

Similarly, commenters advanced no persuasive arguments against implementing full portability as an effective and significant means to address concerns about the ongoing viability of the high-cost fund. Indeed, ILECs were largely silent on the issue of full portability, instead training their guns on the identical support rule, accusing competitive ETCs of receiving "windfall" support, even though—in contrast to ILECs, whose support remains steady even as lines decrease—competitive ETCs lose support when they lose a customer. The FCC has repeatedly found that paying competitive ETCs the same per-line support as the ILEC is competitively neutral, and courts have held portability of per-line ILEC support to be required by the Act. Moreover, the identical support rule is critical to the ability of carriers to compete against heavily-subsidized incumbents whose networks are already in place. The elimination of the identical support rule would restrict the competitive alternatives for rural consumers, in violation of the Act's purposes.

In addition, no commenter has presented any persuasive reason not to require rural ILECs to disaggregate support so that competitors receive the per-line support more closely reflecting the cost of serving a particular wire center. Rural ILECs previously supported disaggregation as a means of preventing "cream-skimming" by competitors, and no explanation has been given for their abandonment of the idea. In our initial comments, we provided several examples demonstrating that disaggregation is an effective means of moderating support levels and ensuring support is properly targeted. No evidence has been presented to support claims that disaggregation presents any unreasonable burden to ILECs.

Finally, there is little evidence in the record that the problems with the current mechanism could somehow be addressed by reverse auctions. Many commenters agree that the reverse auction option must be rejected, and their comments point to serious design and operational problems that would make it extremely unlikely that reverse auctions (even if they were not encumbered by serious conceptual flaws) could be implemented in a way that would effectively advance the universal service and competition goals of the Act. Accordingly, U.S. Cellular and RCC encourage the Joint Board to reject reverse auctions and structure its recommendations around the critical components for long-term reform that have been advanced by U.S. Cellular and RCC in their Comments.

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United States Cellular Corporation ("U.S. Cellular") and Rural Cellular Corporation ("RCC"), by counsel, hereby provide reply comments pursuant to the Joint Board's Public Notice, FCC 07J-2 (released May 1, 2007) ("*Public Notice*") regarding long-term, comprehensive reform of the high-cost universal service fund.

I. INTRODUCTION

U.S. Cellular and RCC have welcomed the opportunity to present to the Joint Board proposals for universal service reform, and we commend the Joint Board for its ongoing efforts to recommend solutions to the complex and controversial problems facing the universal service program. We believe we have crafted a competitively neutral plan for long-term high-cost universal service reform that will enhance the long-term sustainability of the high-cost fund and provide direct, tangible, and significant benefits to consumers in rural America. Furthermore, this proposal can be implemented easily, and it has, in large part, already been endorsed by the Joint Board and the Commission.

Commenters opposing various aspects of our plan have relied upon old and discredited arguments that provide no basis for their assertions that the steps we are suggesting should not be taken. Now is the time for the Joint Board and the Commission to move forward with policy decisions that will preserve and advance universal service and will continue to bring the benefits of competition to the rural marketplace.

II. THE HALLMARKS OF COMPREHENSIVE UNIVERSAL SERVICE REFORM SHOULD BE EFFICIENCY, PORTABILITY, AND DISAGGREGATION

In their Comments, U.S. Cellular and RCC presented a trilogy of proposals to serve as the cornerstones of effective long-term universal service reform. First, high-cost support should be disbursed based upon the costs necessary to construct, upgrade, and maintain efficient telecommunications networks. Second, high-cost support should be fully portable, so that carriers who win customers exclusively receive the support associated with those customers, and so that the level of support is set in a manner that promotes competitive neutrality and market entry. And third, support should be precisely targeted to high-cost areas, so that competitors have appropriate incentives to build and upgrade facilities to reach unserved and underserved rural areas.

These proposals work in complementary fashion to achieve critically important results. The sustainability of the high-cost fund would be enhanced because shifting from an embedded cost regime for rural incumbent local exchange carriers ("ILECs") to a cost system based on the cost of building an efficient network would promote more efficient use of support and reduce upward pressures on fund growth. Competition in rural markets would be promoted because high-cost support would follow customer choice and be used by carriers who have withstood the test of the marketplace by offering services responsive to customer demand. And, most important, consumer welfare would be served because high-cost support would be targeted in the most effective way to benefit consumers in high-cost rural areas, and to provide these consumers with services comparable to those available in urban areas.

The record of this proceeding shows that ILECs and their supporters are intent upon retaining a cost methodology that places little restraint on spending and ensures generous returns on investment. Moreover, these commenters attempt to convince the Joint Board and the Commission to take actions that would move backward toward a time when ILEC hegemony in rural markets was not threatened by competitors and when ILECs were the exclusive recipients of high-cost support.

But there are no convincing arguments in the record demonstrating that the Joint Board's and the Commission's emphasis on competition has been misplaced or ineffective as a vehicle for advancing universal service and benefiting consumers in rural America. The reform package proposed by U.S. Cellular and RCC highlights policies the Joint Board and the Commission have previously endorsed and, if adopted here, will promote efficient use of high-cost funds and to ensure that competitive forces continue to serve consumer welfare in rural America.

In reforming support mechanisms, the Joint Board must face several realities:

- Wireless is the future of voice telecommunications in rural America, and support mechanisms must be modernized to reflect consumers' need for modern communications. Current policies, which protect rural wireline networks *at all costs*, must be reformed.

- Wireless networks require significant investment to build new infrastructure to provide rural consumers with reasonably comparable services at prices reasonably comparable to those available in urban areas, as required by Section 254 of the Act. Rules must provide sufficient support for *consumers* to access these services. Wireline networks were built decades ago and their usefulness is declining. ***Inescapably, portability is the answer. Support must go to the carrier that is actually serving the consumer, not to the carrier that no longer serves the consumer's needs.***

- Paying carriers on their own costs and otherwise circumventing the FCC's own core principle of competitive neutrality violates the Act, which requires the Commission to pursue the dual goals of advancing universal service and competition in rural areas.[1] Forsaking competitive neutrality will introduce tremendous complexities into reform, carry significant litigation risk, and further delay for rural consumers the many improvements that wireless carriers can provide with access to support.

- Providing the right amount of support to all carriers is the key to finding room to fund broadband. Each of our proposals will lower the total size of the fund, making room for the Commission to fund broadband.

A. Long Term, Comprehensive High-Cost Universal Service Reform Must Include Efficient Costing Methodologies.

It is no secret that "the proper measure of cost for determining the level of universal service support is the forward-looking economic cost of constructing and operating the network facilities and functions used to provide supported services . . . ."[2] Given the fact that the Joint Board and the Commission reached this conclusion more than 10 years ago, U.S. Cellular and RCC believe that the time is overdue for reforming the modified embedded-cost methodology for disbursing high-cost funds to rural ILECs. Indeed, six years ago the Commission conceded that it had not anticipated that "the embedded cost mechanism for rural carriers would be in place for this long."[3] Reform will serve consumer welfare because, as the Commission has indicated, "the use of forward-looking economic cost will lead to support mechanisms that will ensure that universal service support corresponds to the cost of providing the supported services, and thus,

[1] *See Alenco Communications v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000) ("*Alenco*"). ("The FCC must see to it that *both* universal service and local competition are realized; one cannot be sacrificed in favor of the other.") (emphasis in original). *See also Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 406 (5th Cir. 1999) ("opening local telephone markets to competition is a principal objective of the Act"); *see id*. at 412 (referencing the dual statutory goals of "provid[ing] sufficient support for universal service" and "encouraging local competition").

[2] *Federal-State Joint Board on Universal Service, Report and Order,* 12 FCC Rcd 8776, 8899, para. 224 (1997) ("*First Report and Order*") (subsequent history omitted). *See also Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 522 (2002) (upholding the FCC's decision to calculate ILEC costs on an efficient basis.*oard on Universal Service*, *Fourteenth Report and Order,* 16 FCC Rcd 11244, 11258, para. 28 (2001), *cited in* Letter from Gene DeJordy, Steve R. Mowery & Mark Rubin, Alltel Wireless, to Marlene H. Dortch, Secretary, FCC, May 31, 2007 ("Alltel Letter"), at 2 n.1.

will preserve and advance universal service and encourage efficiency because support levels will be based on the costs of an efficient carrier."[4]

Whether the Commission specifies a forward-looking cost model or another means of measuring the cost of constructing an efficient network, the key is to move toward a mechanism that promotes efficient operations by rural ILECs. Rural ILECs receive approximately $3 billion annually in Universal Service Fund ("USF") support, an amount that has held more or less constant in recent years despite significant ILEC line losses.[5] It should be among the highest priorities of the Joint Board, in developing its recommendations for reform, to search for ways to introduce efficiencies that will reduce that immense drawdown of support. Replacing the embedded-cost model with a cost methodology that provides support on an efficient basis is one of the most obvious ways to achieve this goal.

There can be no doubt that consumers are harmed by the failure to develop and implement an appropriate methodology for carriers serving rural areas. As U.S. Cellular and RCC have explained, the credo of the current embedded-cost model is "the more you spend, the more you get,"[6] and, since normal business incentives to be efficient are lacking, consumers who contribute to USF are forced to overpay in order to subsidize inefficient investment and expenditures.[7]

For example, small rural ILECs could use softswitches as a lower-cost alternative to legacy infrastructure for their switching needs. Yet the amount of (uncapped) Local Switching

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[4] *Id*. at 8899, para. 225 (footnote omitted).

[5] *See* U.S. Cellular and RCC Comments at 8.

[6] *Id*.

[7] *Id*. at 10.

Support being provided to ILECs fails to accurately reflect these technological advancements.[8] This points to the inescapable conclusion that rural ILECs continue to draw increasing amounts of support even though their networks were fully constructed decades ago, and despite the availability of modern technology to reduce operating costs for small carriers.

Because the current embedded-cost system is harmful to consumers and constitutes an enormous drain on the high-cost fund that threatens its sustainability, ILECs and their supporters face a high burden to prevail in their claim that universal service reform should steer clear of addressing rural ILEC costs. They attempt to meet this burden by arguing that the embedded-cost system is not broken, and therefore does not "need" to be fixed, and that, even if the system is broken, trying to fix it would be too complicated. These unsupported claims are not persuasive.

OPASTCO, for example, advances various arguments in an attempt to defend the embedded-cost model, including claims that the cost-based mechanism has been instrumental in enabling rural ILECs to deploy multi-functional infrastructure capable of providing advanced services, and that, without the cost-based funding methodology, rural carriers would be highly reluctant to make the investments necessary to provide advanced services.[9]

These arguments do not come to grips with the pivotal fact that the embedded-cost system is dysfunctional because it does not require carriers to be efficient.[10] There are no

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[8] *See* www.universalservice.org. (Amounts of uncapped Local Switching Support significantly higher today than it was for example in 2002, even accounting for increased support for CETCs).

[9] Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO") Comments at 4-6. *See also* CenturyTel, Inc. ("CenturyTel") Comments at 9-11; Western Telecommunications Alliance ("WTA") Comments at 9.

[10] Windstream Communications, Inc. ("Windstream"), pinpoints this problem, explaining that "[d]istributing universal service support based on spending ('embedded costs') is neither rational nor objective. The amount spent is not necessarily indicative of the amount of support an efficient carrier would need to satisfy its universal service obligations in high-cost areas." Windstream Comments at 5 (footnote omitted). Windstream also expresses the

effective mechanisms in place to determine whether capital investments and expenditures made by rural ILECs are appropriate or efficient, lowering incentives to curb these outlays. Adherence to an embedded cost methodology certainly is not the only means to ensure that rural ILECs are able to deploy advanced services or to otherwise build out and maintain their network facilities. In fact, requiring rural ILECs to operate efficiently would advance the deployment of ILEC facilities and the provision of services to rural consumers in a manner that ensures sufficient high-cost support mechanisms by squeezing out excessive or redundant rural ILEC costs.

The other argument made by rural ILECs is that the embedded-cost methodology should be retained because there is no effective way to develop and implement an alternative. Therefore, these commenters say, the Joint Board should refuse to recommend a shift until further studies and testing are undertaken.[11]

While it is true that the Joint Board and the Commission have not made any progress on reforming the distribution methodology since 2001,[12] this is not an excuse for continuing to avoid implementing a costing policy that the Commission has consistently endorsed. Substantial consumer benefits—both in terms of reductions in the required levels of high-cost fund support and in terms of the improvements in service quality, expansion of services, and reduction in prices that would result from more efficient carrier operations—warrant a commitment from the

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view that practical realities may require continued use of embedded costs "for now" for the smallest companies. *Id.* at 5 n.11.

[11] *See, e.g.*, BEK Communications Comments at 5; CenturyTel Comments at 19-20; Gardonville Cooperative Telephone Association ("GCTA") Comments at 5; National Exchange Carrier Association ("NECA") Comments at 8; National Telecommunications Cooperative Association ("NTCA") Comments at 12-15; Rural Independent Competitive Alliance ("RICA") Comments at 12-13; Rural Telecommunications Group, Inc. ("RTG") Comments at 4; Telcom Consulting Associates, Inc. ("TCA") Comments at 9; Texas Statewide Telephone Cooperative, Inc. ("TSTCI") Comments at 7-8; Verizon and Verizon Wireless ("Verizon") Comments at 10.

[12] *See* U.S. Cellular and RCC Comments at 5.

Joint Board and the Commission to press ahead with a plan for reforming the modified embedded cost methodology for rural ILECs.

In this regard, it is encouraging that Alltel is seeking to develop mechanisms "to address the inputs, assumptions, and other mechanisms needed to estimate the economic costs of providing universal service efficiently in rural areas."[13] Leadership from the Joint Board and the Commission will provide the much needed impetus to move efforts such as these forward.

B. Making Support Fully Portable Will Sustain the High-Cost Fund, and Retaining the Identical Support Rule Will Preserve Competitive Neutrality.

U.S. Cellular and RCC explained in their Comments that a critical component of long-term universal service reform is finalizing the Commission's efforts to make rural ILECs' support payments fully portable.[14] Under full portability, high-cost support would follow the customer—if a competitive eligible telecommunications carrier ("CETC") wins a customer from an ILEC, for example, then per-line support available to the CETC would be increased and per-line support available to the ILEC would decrease. Even though the Commission has endorsed full portability, it has yet to adopt it. The result has been, in essence, an open-ended "transition" for rural ILECs.[15]

Full portability has two significant advantages that make it an essential component of universal service reform. First, it would shift rural ILEC incentives in the direction of more efficient operations that are more responsive to customer expectations. The current system, in which a rural ILEC suffers no reduction in high-cost support if it loses a customer, provides no such incentives, but instead enables the rural ILEC to continue to draw the same level of high-

[13] Alltel Letter at 2.

[14] U.S. Cellular and RCC Comments at 16-18.

[15] *See id*. at 16-17.

cost support—and increases the per-line support available to all ETCs in the area—regardless of what is happening to the ILEC's customer base.

Second, full portability would provide an effective and significant solution to the Joint Board's and the Commission's concerns about the ongoing viability of the high-cost fund.[16] Under the current system, when a CETC captures a rural ILEC's customer, the high-cost fund essentially pays twice—it makes disbursements to the carrier serving the customer and to the carrier that is no longer serving the customer. Rectifying this illogical and costly arrangement should be a chief component of the Joint Board's recommendations for universal service reform.

ILECs and their supporters for the most part are silent in their comments regarding the issue of whether the Commission should finally make high-cost support fully portable, although Western Telecommunications Alliance ("WTA") does observe that adoption by the Commission of the principle of competitive neutrality does not mean that the principle "must encourage and underwrite artificial competition by offering large amounts of portable 'identical support' to multiple CETCs . . . ."[17] WTA, of course, is wrong. The Fifth Circuit has affirmed the FCC's decisions that universal service programs:

> must treat all market participants equally—for example, subsidies must be portable—so that the market, and not local or federal government regulators, determines who shall compete for and deliver services to customers. . . . [T]his principle is made necessary not only by the economic realities of competitive markets but also by the statute.[18]

ILECs and their supporters do, however, attempt to marshal an attack against the identical support rule. Their familiar refrain is that the rule results in "windfall profits," that

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[16] *See* ComspanUSA Comments at 9 ("If complete portability of funding is adopted, wireline CLEC participation in the fund will not increase the size of the fund.")

[17] WTA Comments at 5.

[18] *Alenco*, 201 F.3d 616.

CETC support should be based on their own costs, that the rule is unnecessary because CETCs do not face the same regulatory obligations as rural ILECs, that the rule has contributed to the rapid growth of the high-cost fund, and that the rule results in excessive subsidies.[19]

U.S. Cellular and RCC anticipated and rebutted virtually all of these arguments in their Comments,[20] so we will only highlight here several key considerations that compel a conclusion that the identical support rule should be retained. First, the Commission has concluded that basing CETC support on ILECs' embedded costs *does not constitute preferential treatment of competitors* and therefore does not violate the Communications Act of 1934 ("Act") or the principle of competitive neutrality.[21] The only way to achieve competitive neutrality is to ensure that carriers competing for the same customers receive the same level of high-cost support. Thus, if a rural ILEC's per-line high-cost support is based on its embedded costs, on its forward-looking costs, or on some other cost methodology, then the high-cost support made available to a CETC for customers captured from the rural ILEC (or for new customers receiving supported service in rural areas) must be calculated in an identical manner in order to maintain a level competitive playing field. Providing more support to the less efficient provider of services confers an artificial advantage not present in a competitive marketplace.

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[19] Some commenters also maintain that the rule has been more anti-competitive than competitively neutral, that the rule does not provide incentives to CETCs to invest in their networks to serve the highest-cost consumers, and that the rule does not relate the need for support with the actual support provided in any rational way. *See, e.g.*, Embarq Corporation ("Embarq") Comments at 22-23; GCTA Comments at 6; Independent Telephone and Telecommunications Alliance ("ITTA") Comments at 44-46; NECA Comments at 9; NTCA Comments at 18-19; Nebraska Rural Independent Companies and South Dakota Telecommunications Association ("NRIC-SDTA") Comments at 10; OPASTCO Comments at 7-11; RICA Comments at 14-15; Rural Iowa Independent Telephone Association ("RIITA") Comments at 6; RTG Comments at 6-7; TCA Comments at 7; TSTCI Comments at 7; Verizon Comments at 13-14.

[20] *See* U.S. Cellular and RCC Comments at 18-28.

[21] *See First Report and Order,* 12 FCC Rcd at 8933, para. 289; *Federal-State Joint Board on Universal Service, Ninth Report and Order and Eighteenth Order on Reconsideration*, 14 FCC Rcd at 20432, 20480, para. 90 (1999).

Second, the identical support rule is a vehicle for promoting competitive entry. Thus, the rule serves as an incentive for competitive carriers to enter rural and high-cost markets if their costs are likely to be lower than, or equal to, the costs of the rural ILEC. Without the receipt of per-line support pegged to the incumbent's costs, it would be difficult for CETCs to compete against entrenched monopoly carriers operating in rural areas with a completely built-out, and heavily subsidized, network.[22]

Third, criticism of the identical support rule often is part of a claim that current universal service policies promote "artificial competition" and lead to the supposedly undesirable result of multiple CETCs providing service in the same rural area.[23] This claim is without merit, because the Act in fact authorizes the designation of multiple CETCs in areas that may not support more than one carrier,[24] and because the identical support rule does not operate to increase high-cost fund disbursements in these circumstances. The reason for this is that high-cost support is fully portable among CETCs.[25]

Fourth, elimination of the identical support rule would provide an artificial competitive advantage to ILECs and would be detrimental to consumers. The reason for this is that, as explained above, the entire purpose of the rule is to achieve competitive neutrality and promote competitive entry, so that consumers benefit from the increased availability of competitive

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[22] *Notice of Proposed Rulemaking Regarding an Interim Cap on High-Cost Universal Service Support for Competitive Eligible Telecommunications Carriers*, WC Docket No. 05-337, CC Docket No. 96-45, U.S. Cellular and RCC Comments, June 6, 2007, at 29.

[23] *See, e.g.*, Frontier Communications ("Frontier") Comments at 4.

[24] *See* Section 214(e)(2) of the Act, 47 U.S.C. § 214(e)(2); *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 418 (5th Cir. 1999).

[25] U.S. Cellular and RCC Comments at 25 ("CETCs only get support when they get customers, and CETCs lose support when customers are competed away.").

telecommunications services consumers take for granted in urban areas.[26] Thus, elimination of the rule would be contrary to the purposes of the Act.[27]

Fifth, proposals that the identical support rule should be replaced with a system under which CETCs receive high-cost funds based on their own embedded costs make no sense in light of the fact that the Commission has already concluded (for the reasons we have described in Section II.A., *supra*) that the embedded cost model is unacceptable because it results in inefficiency.[28]

Finally, it would be impractical to impose embedded costs as the rule for CETC fund disbursements. The production of cost support data would be extremely burdensome because, as Sprint has observed, CETCs do not record their financial information pursuant to the Uniform

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[26] Consumers Union makes the puzzling argument that, because wireless carriers "have now deployed infrastructure in many study areas, the benefits of continued identical support remain unclear." Consumers Union Comments at 57. This characterization of wireless networks as being fully deployed is surprising, given that Consumers Union has organized a campaign to address consumers' concerns regarding "lousy coverage", "dropped calls", and "whether dialing 911 on your cell phone will get you the emergency operator when you need it most". *See* http://www.hearusnow.org/phones/ (viewed June 30, 2007). It should be clear to Consumers Union that the continued availability of high-cost support is critical to the ability of wireless carriers to put the infrastructure in place to provide improved coverage and quality in rural areas that do not support such investments with internally generated capital alone.

[27] *See Alenco*, 201 F.3d at 620 (emphasis in original):

> The Act does *not* guarantee all local telephone service providers a sufficient return on investment; quite to the contrary, it is intended to introduce competition into the market. Competition necessarily brings the risk that some telephone service providers will be unable to compete. The Act only promises universal service, and that is a goal that requires sufficient funding of *customers*, not *providers*. So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act . . . .

[28] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, U.S. Cellular Reply Comments, Sept. 21, 2004 ("U.S. Cellular 2004 Reply Comments"), at 18 (pointing out that "if wireless carriers receive support based on a wireless cost model, the relative youth of wireless networks may lead to a gold-rush mentality as carriers sweep into rural areas on the promise of high-cost funding sustaining bad business decisions"); CTIA–The Wireless Association® ("CTIA") Comments at 9 (footnote omitted) (arguing that a shift to determine CETC support based on embedded costs "would be a significant setback in market-based reforms. An embedded cost system for competitors would require complex and indeterminable new reporting requirements and would simply repeat the mistakes of the past."); Dobson Cellular Systems, Inc. ("Dobson") Comments at 9-10 (footnote omitted) (arguing that, since rural ILEC support currently is based on an "inefficient and irrational cost basis[,]" a better approach than debating the identical support rule would be to provide "ILEC and competitive ETCs alike with support based on the cost of the most efficient network technology for serving a given area.")

System of Accounts or the Commission's jurisdictional separations procedures.[29] Not to mention, the Commission would have to review and approve a different cost study methodology for every carrier seeking to enter as a CETC that uses a new technology with different cost characteristics.

C. Requiring the Disaggregation of Rural ILEC High-Cost Support Would Benefit Consumers in High-Cost Areas.

The third prong of U.S. Cellular's and RCC's proposal for universal service reform, requiring the disaggregation of rural ILEC support, is important because it would have the effect of redirecting support to those highest-cost areas where universal service funding is most needed and would have the most beneficial effect.[30] The current disbursement system is flawed because it does not guard against the use of high-cost support in portions of study areas in which it is possible to provide service at low cost to the carrier. Thus, high-cost funds are used in areas where the support is less needed than it is in other portions of the same study area.

Requiring rural ILECs to disaggregate, at least to the wire center level, would cure this problem, and target support to areas where the support is most needed to provide service to consumers. [31] A further advantage of disaggregation is that it would protect rural ILECs from

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[29] Sprint Comments at 11.

[30] U.S. Cellular and RCC also believe that disaggregation would reduce overall high-cost support to CETCs, at least in the short term. U.S. Cellular and RCC Comments at 30. *See also* Corr Wireless Communications, LLC, Comments at 2 (favoring disaggregation and arguing that the "greater the precision with which the support is targeted at high-cost areas, the less the entire support program costs while still doing its job effectively").

[31] A number of parties support the position of U.S. Cellular and RCC that disaggregation should be mandatory. *See, e.g.*, ComspanUSA Comments at 8; DialToneServices, L.P., Comments at 5-7; Dobson Comments at 2-5; Nebraska Public Service Commission Comments at 7-9; New Jersey Board of Public Utilities Comments at 10-11 (proposing that the FCC "should require all carriers to disaggregate support below the study area, i.e., the wire center level"); South Carolina Office of Regulatory Staff Comments at 2 (arguing that disaggregation to the wire center level would allow USF support to focus on areas needing greater support, and that disaggregation would provide an incentive for CETCs to serve the more rural, higher-cost areas).

subsidized competitive entry in low-cost areas.[32] By the same token, disaggregation would encourage competitive entry in high-cost areas, where competition would be most beneficial to unserved or underserved customers.[33] Finally, substantial evidence suggests that the administrative tasks for rural ILECs to accomplish disaggregation would not be burdensome.[34] A number of very small rural ILECs filed relatively simple and acceptable disaggregation plans back in 2002.

Given these clear advantages of disaggregation, especially from the perspective of consumers who reside in higher-cost areas and who currently are unserved or underserved, it is puzzling that so many rural ILECs and their supporters oppose a reform measure that would require disaggregation.[35] CenturyTel, for example, argues against requiring rural ILEC disaggregation because deciding where to disaggregate is “a time-consuming endeavor” and because the studies used to effect disaggregation are “controversial.”[36] These are not convincing reasons to avoid establishing a policy that would more efficiently retarget the use of high-cost

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[32] *Public Notice* at 4. *See Petition for Agreement with Designation of Rural Company Eligible Telecommunications Carrier Service Areas and for Approval of the Use of Disaggregation of Study Areas for the Purpose of Distributing Portable Federal Universal Service Support*, CC Docket No. 96-45, *Memorandum Opinion and Order*, 15 FCC Rcd 9921, 9929, para. 12 (Com.Car.Bur. 1999); U.S. Cellular 2004 Reply Comments at 6.

[33] Rural Task Force, White Paper #6, *Disaggregation and Targeting of Universal Service Support* (Sept. 2000)(“White Paper #6”) at 6 (disaggregation enables competitive entry and “targets . . . support to the most rural and high-cost zones within a given study area, enabling customers in those areas to receive services that are truly comparable to those provided in urban areas”).

[34] U.S. Cellular and RCC Comments at 30-31.

[35] *See, e.g.*, BEK Communications Comments at 5; Embarq Comments at 20-21; Fred Williamson and Associates, Inc. (“FWA”) Comments at 27; GCTA Comments at 5; ITTA Comments at 39; NTCA Comments at 16-17; NRIC-SDTA Comments at 22; OPASTCO Comments at 19-20; RICA Comments at 14; RIITA Comments at 5; RTG Comments at 5; TSTCI Comments at 7; WTA Comments at 22.

[36] CenturyTel Comments at 21. The only controversies that Commenters are aware of involving disaggregation involve CenturyTel’s plans, which have for example, been rejected by the Washington Utilities and Transportation Commission. *See* In the Matter of the Disaggregation Plans of Asotin Tel. Co., CenturyTel of Cowiche, et al., Docket Nos. UT-013058 and UT-023020, Order Rejecting Disaggregation Filings by Asotin Tel. Co. and CenturyTel, and Directing Rural ILECs to File Disaggregation Plans With the Commission Not Later Than August 23, 2002 (Wash. Util. & Transp. Comm’n, Aug. 2, 2002).

funds. Opponents of disaggregation must explain why their four square support of disaggregation, as evidenced in White Paper #6, has now been abandoned.[37]

Together, these three reforms will advance each of the goals that Congress has set forth. Promoting efficiency and disaggregation will advance universal service. Portability will advance competition and sustain the program. The passage of time has not changed the fundamental fact that the FCC set a clear course toward reforming universal service which was sound and which must be continued if the goals set by Congress are to be achieved.

III. REVERSE AUCTIONS WOULD NOT ADVANCE THE GOALS OF THE ACT REGARDING UNIVERSAL SERVICE AND COMPETITION, AND THEREFORE SHOULD BE REJECTED

U.S. Cellular and RCC, in recommending in their Comments that the Joint Board should reject reverse auctions as a vehicle for long-term universal service reform, identified fundamental problems with the concept of reverse auctions as a means of providing high-cost support in rural areas. There is little evidence in the record that these fundamental problems could somehow be addressed in a way that would make reverse auctions a viable option for reform.

In addition, many commenters echo the recommendation of U.S. Cellular and RCC that the Joint Board reject the reverse auction option, and their comments point to serious design and operational problems that would make it extremely unlikely that reverse auctions (even if they were not encumbered by serious conceptual flaws) could be implemented in a way that would effectively advance the universal service and competition goals of the Act.

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[37] See White Paper #6, *supra*, at 6 ("Both competitive and incumbent carriers agree with the need to disaggregate and target universal support below the study area level. Incumbent carriers favor disaggregation in order to properly target support to high-cost areas and to avoid cream skimming of their most lucrative customers. Competitive carriers seek disaggregation in order to develop rational entry strategies and to facilitate portability of support.")

In light of the myriad problems associated with any reverse auction option, U.S. Cellular and RCC encourage the Joint Board to reject reverse auctions and structure its recommendations around the critical components for long-term reform that have been advanced by U.S. Cellular and RCC in their Comments.

A. Fundamental Flaws in the Reverse Auction Mechanism Make It a Poor Choice for Long-Term Universal Service Reform.

There are two fundamental problems with using reverse auctions as a mechanism for disbursing high-cost support. First, in order for auctions to work efficiently, competing bidders must be "evenly matched" and must have sufficient information to enable them to make rational bidding decisions. Reverse auctions for the disbursement of high-cost support would not meet those criteria. If the auction were structured such that rural ILECs and wireless CETCs would bid directly against each other, it would be virtually impossible for the auction mechanism to overcome the enormous disadvantage wireless CETCs would face as a result of the fact that, unlike rural ILECs, they have not reached advanced stages of building out infrastructure to serve rural areas. In these circumstances, it would be extremely difficult for wireless carriers to bid competitively against incumbents that have fully deployed networks as a result of decades of subsidization.

Even if the auction were structured such that wireless carriers would bid only against other wireless carriers for the right to compete against the incumbent wireline carrier, it would be highly unlikely that the auction would produce efficient results because none of the wireless carriers would possess sufficient information about the future costs of their infrastructure deployment to fashion informed bids. Thus, there could be no assurance that the lowest bidder would receive sufficient support over the auction term to be able to compete effectively against the incumbent and provide services to rural customers that are reasonably comparable to services available in urban areas.[38]

Second, reverse auctions, especially if structured on a "winner takes all" basis, would risk freezing out competition and perpetuating a monopoly provider of services to consumers in rural areas. Such a result would conflict with the objectives of the Act,[39] and would also deprive consumers of the benefits of choice, including lower rates, increased quality of service, the provision of innovative services, and the many advantages of mobile wireless services.

There is little evidence in the record that a reverse auction structure could be devised in a way that could overcome these flaws that are inherent in the concept of reverse auctions for the provision of high-cost support. For this reason alone, the Joint Board should not recommend that reverse auctions be adopted. Moreover, as we discuss in the next section, the details of auction design and operation illuminate further reasons for rejecting reverse auctions.

B. The Record Reveals That Reverse Auctions Would Have Insurmountable Design and Operational Problems.

As U.S. Cellular and RCC observed in their Comments,[40] a significant operational problem posed by reverse auctions is the risk of stranded investment.[41] If a carrier (either an incumbent or a competitor) wins an auction and then makes investments to deploy infrastructure

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[38] *See also* RICA Comments at 9 (criticizing CTIA's "winner takes more" reverse auction proposal because, without rigorous standards, carriers basing bids on estimates of costs of constructing and operating a quality network will be disadvantaged in competition with other carriers that base their bids on the minimum possible expenditure); RTG Comments at 2.

[39] *See* NTCA Comments at 7-8 (arguing that a reverse auction system that limits support to the lowest bidder is unlikely to ensure that consumers in rural areas receive comparable services to those received by urban consumers); OPASTCO Comments at 12. *See also* BEK Communications Comments at 3 (arguing that underbidding may lead to sacrifices in the quantity and quality of services offered).

[40] U.S. Cellular and RCC Comments at 39.

[41] *See, e.g.*, GCTA Comments at 3; OPASTCO Comments at 13; TSTCI Comments at 6.

and provide services to consumers during the auction term, the carrier will face the risk that it may not be able to fully recover this investment if it is not successful in winning the next auction for a subsequent term. This risk would dampen the incentives for investment,[42] to the detriment of consumers, and would also make it more difficult for carriers to obtain third party financing for the capital expenditures necessary for infrastructure deployment.

A further operational problem involves defining a reasonable auction term.[43] If the auction term is too short, then the stranded investment problems described above are accentuated and incentives for investment are diminished. If, however, the auction term is too long, this gives the auction winner little incentive to perform well[44] and, as OPASTCO explains, risks locking in cost assumptions that would make it difficult for the carrier to meet evolving customer expectations throughout the full course of the auction term.[45]

Reverse auctions may be able to work effectively if the subjects of the auction are fungible, easily definable goods or services.[46] But, as NECA explains, rural telephone service "is not a simple, easily-defined commodity" and this would pose extremely complex auction

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[42] *See, e.g.*, RIITA Comments at 4.

[43] *See* WTA Comments at 14 (arguing that the incongruity between the lengthy depreciation lives of telecommunications equipment and the likely effective periods of reverse auctions would cause problems for rural infrastructure investment financing, incentives, and cycles).

[44] U.S. Cellular and RCC Comments at 39 n.54.

[45] OPASTCO Comments at 13; *see* WTA Comments at 15-16. ITTA points out that further problems would be encountered at the end of an auction term. *See* ITTA Comments at 23 (arguing that the use of auctions could risk deteriorating service, especially in the final years of the auction term, that there could be difficulties associated with replacing the auction winner toward the end of the service term, and that there could be a forced change in service providers every set number of years).

[46] NECA Comments at 4.

design problems regarding the scope of services covered and the measurement of service quality.[47]

Moreover, as U.S. Cellular and RCC demonstrated in their Comments,[48] in order for a reverse auction to be competitively neutral and to produce efficient results that would benefit consumers in rural areas, the service areas covered by an auction must be rationally designed. As WTA argues, difficult issues are presented regardless of whether small or large service areas are selected as part of the auction design.[49]

Finally, in addition to the design and operational problems discussed above, commenters also identify a wide range of administrative issues that would be critical to the effective operation of reverse auctions but that would be difficult to resolve. These issues include how to qualify bidders, how to address failures to fulfill carriers' obligations, and how eligibility rules should be defined.[50]

C. The Joint Board Should Reject Reverse Auctions in Favor of a Better Path to Universal Service Reform.

The task before the Joint Board in this proceeding is to define and recommend that optimum set of policies to shape long-term reform that will fulfill the statutory goals of preserving and advancing universal service and promoting competition in local exchange markets. In developing these policy recommendations, the Joint Board should weigh proposals for reverse auctions against other proposals for achieving long-term universal service reform.

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[47] *Id*. at 5.

[48] U.S. Cellular and RCC Comments at 38.

[49] *See* WTA Comments at 17-18.

[50] *See* ITTA Comments at 20; NECA Comments at 5-6.

Reverse auctions should be rejected because they pose too many risks and present too many unanswered questions. As U.S. Cellular and RCC demonstrated in their Comments, and as the record discussed above confirms, reverse auctions cannot be structured in a way that would place ILECs and wireless CETCs on an equal footing. Moreover, reverse auctions would place carrier investment as well as consumer welfare at risk.

Thus, instead of wrestling with the insoluble problems presented by reverse auctions, the Joint Board should embrace and recommend a more practical, reliable, and effective path to universal service reform that will conform with the requirements of the Act, enhance the sustainability of the high-cost fund, and serve consumers by meeting their expectations for high quality services at affordable prices. The proposal for long-term comprehensive universal service reform presented by U.S. Cellular and RCC in their Comments, and further discussed in Section II, *supra*, meets these criteria and therefore should be recommended by the Joint Board.

IV. **CONCLUSION**

The Joint Board should recommend the various components of the plan proposed by U.S. Cellular and RCC because it is fully consistent with Congressional goals of advancing universal service, promoting choices for rural consumers, and sustaining the high-cost fund in the long term.. The Joint Board should not recommend the use of reverse auctions for the disbursement of high-cost support because fundamental flaws inherent in the auction mechanism would prevent it from serving universal service goals or promoting competition.

Respectfully submitted,

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