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July 15, 2010

**VIA E-MAIL & UPS OVERNIGHT DELIVERY**

Mr. David Danner, Executive Director & Secretary  
Washington Utilities and Transportation Commission  
1300 South Evergreen Park Drive SW  
P.O. Box 47250  
Olympia, WA 98504-7250

**Re: Comcast Phone of Washington, LLC's Reply Comments to the WUTC's  
Questions Concerning Appropriate Universal Service Policies in Washington  
Docket No. UT-100562**

Dear Mr. Danner:

Enclosed for filing are an original and twelve (12) copies of Comcast Phone of Washington, LLC's Reply Comments to the WUTC's Questions Concerning Appropriate Universal Service Policies in Washington in connection with the above-referenced docket.

Please feel free to contact me with any questions or concerns you may have regarding this filing.

Sincerely,

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Enclosures

Cc: Brian Thomas, WUTC (E-mail)

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

Policy Statement to Review State Universal Service Policies

Docket UT-100562

**COMCAST PHONE OF WASHINGTON, LLC'S REPLY COMMENTS TO  
THE WUTC'S QUESTIONS CONCERNING  
APPROPRIATE UNIVERSAL SERVICE POLICIES IN WASHINGTON**

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**Dated: July 15, 2010**

**Reply Comments of Comcast Phone of Washington, LLC re: WUTC Questions  
Concerning Appropriate  
Universal Service Policies in Washington**

**Docket UT-100562**

Comcast Phone of Washington, LLC (“Comcast”) is pleased to respond to the comments filed by other parties to the questions posed by the WUTC concerning appropriate universal service policies in Washington. Many parties’ comments are aligned with Comcast’s position that a universal service fund should not be established in Washington, unless it can be demonstrated that there is a need to provide regulated below-cost voice or broadband service to an identified group of citizens in the State.<sup>1</sup> Other parties support the creation of a Washington universal service fund primarily to offset reductions in intrastate access revenues (from the decline in access minutes and/or proposed reductions in intrastate access rates).<sup>2</sup>

The Washington Independent Telecommunications Association (“WITA”) presents the case for establishing a state USF, which crystalizes the make-whole approach advocated by many ILECs in many jurisdictions.<sup>3</sup> Comcast stated its opposition to the make-whole approach in its comments, and will now expand on its critique based on the new information and further exposition of the approach advocated by WITA.

The key points of WITA’s position appear to be, as follows:

1. The public switched telephone network (“PSTN”) is the foundation for communications services, whether wireline, wireless, or broadband.<sup>4</sup>

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<sup>1</sup> See, Verizon letter of June 16, 2010 and Integra Telecom’s Response.

<sup>2</sup> See, WITA Comments, Comments of AT&T Communications.

<sup>3</sup> AT&T also supports the creation of a State fund to offset revenues lost as a result of bringing intrastate switched access rates into parity with interstate rates. Our discussion of the make-whole paradigm in these reply comments is also applicable to the position espoused by AT&T.

<sup>4</sup> WITA Comments, at 3.

2. The relative low density of the areas served by most WITA members makes it very expensive to build and operate the PSTN.<sup>5</sup>
3. Competitors are cream-skimming.<sup>6</sup> In particular, cable provides voice service to the donut hole (the denser areas) and fails to serve the rest of rural exchanges.
4. The WITA member companies receive a substantial portion of their revenues from intercarrier compensation and federal USF.<sup>7</sup>
5. Intercarrier compensation revenues have declined substantially over the past several years.<sup>8</sup>
6. Reductions in intercarrier compensation rates and federal USF funding would exacerbate the threat to the ability of WITA members to provide service at reasonable and sustainable rates.<sup>9</sup>

There are three “missing links” to the logic. First, WITA views the industry from the perspective of a local monopoly, thus ignoring the reality of competition and the benefits of competition. Second, WITA treats its member companies as if they are all rate-of-return regulated, with an entitlement to a given level of revenue from regulated services. Third, WITA ignores some of the most important results of the costing analysis present in the FCC’s broadband plan. The cost study shows that wireless technology would be the most efficient technology to extend broadband service to many unserved areas. This implies that the WITA members would not necessarily be the recipients of a properly constructed, competitively-neutral subsidy.

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<sup>5</sup> WITA Comments, at 5.

<sup>6</sup> WITA Comments, at 7.

<sup>7</sup> WITA Comments, at 11.

<sup>8</sup> WITA Comments, at 12.

<sup>9</sup> WITA Comments, at 13-17.

## Competition is a Good Thing

WITA's initial discussion of telecommunications networks places the incumbents' PSTN at the top of a hierarchy of all other networks. The dependence of all other networks (including wireless and broadband) on the PSTN, appears to be a central reason for WITA's conclusion that the ILECs' network must be subsidized in order to maintain the viability and utility of all communications services.

WITA's argument misses the point about competition. In a competitive market, there should be no dominant service provider, upon which all other providers must rely. And there should be no presumed recipient of subsidy funds. To the extent that other carriers continue to be dependent on the ILECs, however, this is due to the decades-long monopoly of the incumbent carriers, and the barriers that other carriers have encountered in entering and competing in a number of rural markets. If competition is allowed to unfold in all areas, there is every reason to believe that the incumbents will no longer have a special place as the default recipient of universal service subsidies.

It is also important to recognize that the ILECs receive many advantages from their historic monopoly, which likely offset much of the obligations of serving as the carrier of last resort. Much of the incumbents' costs of building their rural networks were incurred during the monopoly era, when the ILECs' return on investment was virtually guaranteed. Further, over the last two decades, a substantial portion of the capital expenditures to build facilities have been depreciated. Nationwide, by the end of 2009, 81% of total plant in service of the mid-sized ILECs was depreciated, i.e. paid for by ratepayers.<sup>10</sup> This should generate enormous savings going forward to ratepayers. Second, since the network has already been built, there is little incremental cost in serving a subscriber that is already passed. Hence, it is in the financial interest of the ILEC to offer service to all customers, rather than a burden to serve any customer already passed by existing facilities.

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<sup>10</sup> See, FCC, ARMIS Report 43-01, showing \$34 billion of accumulated depreciation on gross plant in service of \$42 billion.

Another key point is that many competitors are not cream skimmers, who are undermining the well-oiled system of internal cross-subsidies. Rather cable and wireless, companies and other competing providers force the incumbents to invest in new technology to remain competitive. The new entrants have also invested tens of billions of dollars of their own money in the last several years, thereby narrowing substantially the broadband availability gap that had existed. For example, cable companies have now deployed high speed Internet service to over 122 million homes, compared to only 90 million homes in 2003.<sup>11</sup> In light of the vital role of competitors in building the Nation's and the State's broadband network, therefore, it is important that universal service subsidies do not constitute an unwarranted transfer payment from one group of companies to the "default" winners – the ILECs.

## **Make Whole is the Wrong Paradigm**

The WITA estimates what the initial size of a state universal service fund would be by taking the difference between each ILEC's composite intrastate switched access rate and its composite interstate switched access rates multiplied times the minutes of use for 2008 reported by the ILEC.<sup>12</sup> Using a \$16.00 local rate benchmark, this offset was calculated based upon the working loops reported for the third quarter of 2008. The size of the WUSF after completion of a transition period to bring local rates up to the benchmark is \$27.5 million.

A state USF plan that worked the way that WITA contemplates would be a make-whole plan -- pure and simple. The purpose of the plan, as well as the determination of the size and allocation of funds, would be to offset access revenue losses caused by reducing intrastate access rates to interstate levels. Also, as WITA explains, "the establishment of a WUSF could reduce some of the uncertainty created by the loss of access minutes today and the transition from a known federal USF to an unknown CAF

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<sup>11</sup> [www.ncta.com/Statistics.aspx](http://www.ncta.com/Statistics.aspx) and [www.ncta.com/Stats/BroadbandAvailableHomes.aspx](http://www.ncta.com/Stats/BroadbandAvailableHomes.aspx), last accessed on July 12, 2010.

<sup>12</sup> WITA Comments, at 22.

[Connect America Fund].”<sup>13</sup> The essence of WITA’s position appears to be that revenues from intrastate access are an entitlement, and it is the obligation of ratepayers statewide to replace losses from competition or from a regulatory decision to bring these rates closer to cost.

The missing link in WITA’s paradigm is a demonstration that a make-whole fund would provide the right level and allocation of funds needed to achieve well-defined social objectives. It is not tied to an assessment of a broadband availability gap, or of shortfall between the total revenues and the going-forward cost of serving particular groups of customers. Under a make-whole plan, the exact size and allocation of the state USF would be determined entirely by the historic levels of intrastate access revenues. But since there are so many factors that are responsible for the level of historic “support” built into intrastate access charges, there is no reason for basing a state USF on these so-called levels of support. To take an example, we compare the two operating companies of FairPoint Communications in Washington. The first, Ellensburg, serves an area with a line density of 13.7 loops per square mile. The second, YCOM, serves a much denser area with 61.8 loops per square mile. Yet, the computed “subsidy” needed per line is \$3.90 per month in Ellensburg (the much more rural area) versus \$4.66 per month in YCOM.

It is also important to question whether a subsidy targeted to offset any reduction in intrastate access rates is likely to respond to any well-defined social objective. Millions of dollars of the subsidy would be directed to companies whose “shortfall” is very small and may well be offset by new revenues from broadband services. For example about \$5 million of the \$27 million subsidy fund would be accounted for by the 69,900 lines in the former Embarq operating territory. The local rates that would result from a dollar-for-dollar offset of setting intrastate access rates at interstate levels would be \$22.83. Several questions are in order. First, would local rates really have to rise, or has the average customer already generated new revenues from unregulated services well in excess of the additional \$6.43 per line lost from a reduction in intrastate access

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<sup>13</sup> WITA Comments, at 14.

charges?<sup>14</sup> Second, even if local rates would have to increase to \$22.83, would this be harmful? Third, why is the subsidy based on the level of access revenues received in 2008, rather than access revenues from some other point in time? If, as WITA claims, there has been a significant hemorrhage of revenues the last several years, why is it sensible to replace revenues lost since 2008 and not before (or after)?

By comparison to the WITA proposal, it is interesting to consider how small a state USF would need to be, assuming it is needed at all, if it were targeted more directly to the ILECs with the greatest need. For example, if the intrastate access offset technique were limited to ILECs whose local rate would exceed \$36.00 in the “make-whole” world, then the total USF would be about \$2 million annually (*less than one-tenth the \$27 million fund size computed by WITA*).

Company	Local at Parity	Subsidy to keep local at \$16
Inland	46.16	\$957,000
Pioneer	40.16	\$222,000
Toledo	49.75	\$456,000
Wahkiakum	40.86	<u>\$349,000</u>
		\$1,984,000

This illustration is not meant to imply that any aspect of the WITA approach is correct. However, it does show that a wholesale adoption of a make-whole approach applied to all ILECs would impose a very high price tag on ratepayers. Moreover, even a limited USF may not be needed if cost reductions and new revenue sources are added into the equation.

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<sup>14</sup>This represents the difference between Embarq’s local rates, which are now \$16.40, and the local rate following a dollar-for-dollar offset to the revenues lost when intrastate access charges are brought into parity with interstate rates.



## **Lessons from the National Broadband Plan**

According to WITA, companies that serve predominantly rural areas have a significant burden, and a concomitant need for a subsidy, because of the “donut and hole” problem. WITA uses this term to describe the situation in relatively sparsely populated areas, where the population is concentrated in a small central location, such as a town – the donut “hole.” The remaining population is then widely dispersed across the entire donut. This has two effects on the cost of serving the rural area. First, the cost of serving the donut is much higher than would be indicated by the average density of the entire area. Second, competition, which is posited to be limited to the “hole,” skims the cream – the profits from serving the town’s business and residential customers. This undermines any cross-subsidy between the hole and the donut.

The WITA comments present several examples of this “donut and hole” problem; there are two examples from CenturyLink’s exchanges in Forks and Ritzville. In Forks, the claimed investment per line outside of what WITA refers to as the Central Office Customer Serving Area (“COCSA”) is 5 times greater than within the relatively dense COCSA. In Ritzville, the investment per line is 6 times greater than in the COCSA. These very high investment cost estimates appear to be driven by the very long average loop length (which average 6.1 miles outside the COCSA in Forks and 16.4 miles outside the COCSA in Ritzville.)

What lessons should be learned from this exposition of the “donut and hole” issue? WITA’s answer is that this proves: (1) competitors are cream skimmers; (2) the ILEC’s have a very costly obligation of serving the entire market; (3) this burden has grown since the cream skimmers have taken away the high fat content leaving the skim milk to fend for itself.

The lesson from the FCC’s Broadband analysis is very different. It shows that the cost of serving these highly dispersed customers is much lower with wireless technology than wireline technology. According to the FCC’s broadband cost model, the broadband gap in Adams County (where Ritzville is located) is \$12 million. This represents the

twenty-year lifetime gap between the incremental revenues from the broadband services and the investment and lifetime operating costs. According to the FCC, this subsidy is needed to extend service to the 468 homes, which represent only 8% of the homes in the county that are unserved by broadband facilities. The per-home subsidy is an amazing \$26,576.

Thus far, the data seem to confirm the WITA story that there are very costly homes to serve, which require substantial subsidy. But the second-half of the story is that the cost of serving many of these homes would be much lower if 4G wireless technology were used. In Adams County, if a 4G fixed wireless network were to be used instead of the ILEC's wireline network, the broadband gap would be cut at least in half by \$6 million.<sup>15</sup> On a nationwide basis, the broadband gap also is nearly cut in half from \$23.5 billion to only \$12.9 billion if fixed-wireless 4G networks are used everywhere the population is not yet served.<sup>16</sup>

This means that the subsidy policy would be much different if the goal is to provide universal service efficiently rather than to make the ILEC whole. Moreover, if the FCC were to provide much of the subsidy of extending broadband to the unserved areas, there is no reason to expect that any additional subsidy would be needed from a state fund.

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<sup>15</sup> It is not possible to compute the exact size of the gap using wireless service from the data made available by the FCC. The difference in investment cost for the DSL versus the wireless scenarios, however, is about \$9 million compared to less than \$3 million.

<sup>16</sup> The Broadband Availability Gap, OBI Technical Paper No. 1, at 77.