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REPRESENTING
THE ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE
EN BANC HEARING ON HIGH-COST UNIVERSAL SERVICE SUPPORT IN AREAS SERVED BY RURAL CARRIERS

PANEL 2: BASIS OF SUPPORT FOR CETCS AND TRANSFERRED EXCHANGES

NASHVILLE, TENNESSEE

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Competitive eligible telecommunications carriers (CETCs) serving rural telephone company service areas should receive universal service support that is based on their own embedded costs of providing the supported services. This would introduce the same rationality and accountability into the system for these carriers that already exists in the mechanism for rural incumbent local exchange carriers (ILECs). It would also help to sustain the High-Cost program in a manner that enables all ETCs to receive sufficient support to achieve the universal service objectives of the Telecommunications Act of 1996 (1996 Act, the Act).

There is no basis to presume that providing CETCs with the ILEC's identical per-line support amount will provide each CETC with "sufficient," but not excessive support, as called for by Section 254(b)(5) of the Act. In addition, Section 254(b)(5) provides that universal service support be "specific," but allowing CETCs to receive support based on the ILEC's costs is not at all specific to the CETC's own unique costs and circumstances.

Basing CETCs' support on their own embedded costs would also help to ensure compliance with Section 254(e) of the Act, which requires that support be used only for the provision, maintenance and upgrading of facilities and services for which the support is intended. It is clear that the support rural ILECs receive has been used for its intended purposes since it is based almost entirely on their own past actual investment and expense payments, or reductions in other rates. However, it is nearly impossible to discern how competitors use the support they receive when it is based on the incumbent's actual spending record.

When a CETC has lower costs than the ILEC, the identical support rule provides the CETC with an unfair competitive advantage. The fact that a CETC may have lower per-line costs than the ILEC with which it competes does not reflect inefficiency on the part of the ILEC, as wireless carriers and their representatives like to suggest. What it does reflect is the fact that ILECs and CETCs are not at all similarly situated. For instance:

- Competitive carriers are not required to provide ubiquitous service at the time of their request for ETC designation. Rural ILECs, as the recognized carriers of last resort in their service areas, have built ubiquitous, high-quality infrastructure that serves the most remote and highest-cost customers.

- CETCs can potentially be designated for a different, and sometimes significantly smaller service territory than the incumbent's study area. This makes it much easier for a competitive carrier to meet the Act's prerequisites for ETC designation.

- CETCs are typically not held to the same stringent service quality and reliability standards and customer billing requirements generally imposed on ILECs by state commissions. Consequently, while rural ILECs provide high-quality, reliable service, many wireless carriers are still offering what can only be considered a "best effort" service in rural areas.[1]

[1] In its Order approving Cingular's acquisition of AT&T Wireless, the FCC recognized that "there remain qualitative differences between wireless and wireline services" and that "wireline local exchange services may have comparative advantages in reliability, E-911 coverage, ubiquity, and lower-cost unlimited local calling." *See, Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation, For Consent to Transfer Control of Licenses and Authorizations,* WT Docket No. 04-70, *Applications of Subsidiaries of T-Mobile USA, Inc. and Subsidiaries of Cingular Wireless Corporation, For Consent to Assignment and Long-Term De Facto Lease of Licenses,* WT Docket No. 04-254, *Applications of Triton PCS License Company, LLC, AT&T Wireless PCS, LLC, and Lafayette Communications Company, LLC, For Consent to Assignment of Licenses,* WT Docket No. 04-323, Memorandum Opinion and Order, FCC 04-255 (rel. Oct. 26, 2004), ¶247, fn. 559.

- Rural ILECs have invested in their networks to accommodate increased demand for network capacity caused by longer holding times when customers connect to the Internet. As a result, customers pay nothing extra when they use their landline connection for Internet access. In contrast, Internet access over a mobile wireless connection, if available, is considered a premium service and customers typically pay an extra charge for the service.[2]

In short, ILECs assume the full obligations of carriers of last resort, offering reliable, high-quality, facilities-based service to everyone in their service areas. CETCs, on the other hand, receive the ILEC's cost-based support, but with significantly fewer expectations and requirements placed on them. Clearly, this constitutes an unfair competitive advantage. It also creates arbitrage incentives for competitive carriers to seek ETC status in areas where they may not have otherwise, causing the size of the Fund to grow unnecessarily.

A recent decision by the District Court of Nemaha County, Kansas, confirms that providing CETCs with the ILEC's cost-based support is not competitively neutral. In *Bluestem Telephone Company, et. al. vs. Kansas Corporation Commission*, the Court overturned a decision by the Kansas Commission that made the state universal service support received by Kansas rural ILECs portable to competitors on a per-line basis. Like the federal rural high-cost mechanism, the state's support system is based on the ILEC's embedded costs. The District Court found that:

> The order of the [Kansas] Commission violates the [state's] statutory requirement to make distributions in a "competitively neutral manner," because the Commission has failed to evaluate all the necessary costs/expense information from all providers. The LEC's [sic] are different in structure and treatment as to rates then the wireless providers. Attempting to establish competitive neutrality without evaluating all providers' costs and expenses, means that the [Kansas] Commission has compared apples and oranges. In order that its orders are

[2] In its Triennial Review Order, the FCC recognized that, among other things, wireless CMRS connections in general do not yet equal traditional landline local loops in their ability to handle data traffic. *See, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Report and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17119-17120, ¶230 (2003).

> competitively neutral, the [Kansas] Commission must compare the same units of measurement.[3]

This decision makes clear that there is nothing competitively neutral about requiring rural ILECs to provide extensive data demonstrating above-average costs in order to qualify for support, while not requiring competitors to provide <u>any</u> cost justification for their own receipt of support. If the Joint Board wishes to adhere to the FCC's principle of competitive neutrality,[4] then it must recommend that the Commission immediately eliminate the identical support rule, and begin the process of basing CETCs' support on their own embedded costs.

Providing higher per-line support to the incumbent than to the CETC would not pose a regulatory barrier to competitive entry in rural areas. Mobile wireless providers sought after and obtained spectrum licenses for rural areas, either through auction or lottery, without any expectation of universal service support. These carriers have been successfully serving rural markets for many years now without any high-cost funding.

In the FCC's Ninth CMRS Competition Report, the Commission found that less densely populated counties (100 persons per square mile or less) have an average of 3.7 mobile competitors.[5] The FCC concluded that "CMRS providers are competing effectively in rural areas."[6] Therefore, basing CETCs' support on their own costs will not negatively affect their ability to compete in rural areas. All it will do is eliminate the perverse incentives that currently exist to seek ETC status merely to receive windfall support payments.

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[3] In the District Court of Nemaha County, Kansas, *Bluestem Telephone Company, et. al vs. Kansas Corporation Commission*, Case Nos. 01-C-39, 01-C-40, 03-C-20, and 2004-CV-19, Memorandum Decision (rel. April 30, 2004), p. 10.

[4] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8801, ¶47.

[5] *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, CC Docket No. 04-111, Ninth Report, FCC 04-216 (rel. Sept. 28, 2004), ¶109.

When CETCs are able to receive windfalls of support based on the ILEC's costs, it places unnecessary strain on the Fund. This threatens the High-Cost program's sustainability and the ability of all ETCs to receive sufficient support. A review of Fund size projections from the Universal Service Administrative Company (USAC) validates the Joint Board's prior assertion in the Portability Recommended Decision that it is the CETCs that are drivig the rapid growth in the rural High-Cost program.[7]

($Millions)	**1st Quarter 2003 Support**	**1st Quarter 2004 Support**	**1st Quarter 2005 Support**	**% Change 1Q 2003 – 1Q 2005**	**Two-Year Support Increase**	**% of Total Two-Year Support Increase**
Rural High-Cost Support						
ILEC	$603.1	$609.9	$621.6	3.1%	$18.6	16.6%
CETC	$16.6	$75.7	$109.8	560.5%	$93.1	83.4%
Total	**$619.7**	**$685.6**	**$731.4**	**18.0%**	**$111.6**	**100.0%**

Among other things, this chart illustrates that CETCs are responsible for approximately 83 percent of the growth in the rural portion of the High-Cost program, from 1st Quarter 2003 to 1st Quarter 2005.[8] It also shows that over the past two years, the support earmarked for CETCs in rural service areas grew by a multiple of more than six,[9] while support for rural ILECs increased just three percent. It stands to reason, then, that the way to directly address the

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[6] *Id.*, ¶111.

[7] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 19 FCC Rcd 4257, 4285, ¶67 (2004) ("Much of this growth [in high-cost support] represents supported wireless connections that supplement, rather than replace, wireline service. Our examination of the record reveals the potential for uncontrolled growth as more and more competitive ETCs are designated in rural and high-cost areas.").

[8] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2003* (Nov. 1, 2002), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2005* (Nov. 2, 2004), Appendix HC01.

[9] The support amounts presented for CETCs reflect both existing CETCs as well as competitive carriers that have ETC applications that are pending. In the past, some wireless carriers and their representatives have argued that it is not appropriate to include support amounts attributable to carriers with pending ETC applications since they have yet to receive any support. However, USAC includes support amounts for yet-to-be-approved CETCs in its fund demand, which determines the contribution factor. Therefore, the inclusion of support amounts for pending CETCs

significant growth in the rural portion of the High-Cost program is to immediately abolish the identical support rule and move toward basing support for CETCs on their own costs. This would effectively eliminate the wasteful payout of windfall support amounts that threaten the Fund's viability while still ensuring that all ETCs receive sufficient support.

OPASTCO recommends that the Joint Board and/or FCC hold industry workshops to develop the accounting mechanisms through which CETCs in rural service areas would be required to report their embedded costs. A chart of accounts should be developed that is appropriate for CETCs in each industry segment (*i.e.*, wireless, wireline, etc.). The Joint Board and FCC should initially focus their attention on developing cost reporting rules for wireless CETCs since they presently receive approximately 95 percent of the projected universal service support going to CETCs in rural service areas.[10]

Obviously, the specific types of costs reported by wireless ETCs and ETCs using other technology platforms will need to differ from the types of costs that LECs are required to report. However, the level of detail required from every ETC, regardless of technology, should be the same. There should be cost reporting parity between ILECs and CETCs. Cost studies should sufficiently rationalize a CETC's costs in a manner that approximates the results obtained by ILEC cost studies.

The Joint Board and Commission may also wish to consider developing an average schedule option for CETCs that would provide these carriers with a choice between submitting their own annual cost study or relying on formulas that would simulate the embedded costs of

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is quite appropriate in this type of analysis, since it is reflected in the contributions that carriers are required to make today.

[10] Approximately $104.3 million, or 95 percent of first quarter 2005 projected universal service support payments for CETCs in rural service areas is going to wireless CETCs, with the remaining $5.5 million, or 5 percent, going to wireline CETCs. These figures are based on a conservative identification of known wireline vs. wireless CETCs listed on USAC's high-cost support projection summaries. *See*, Universal Service Administrative Company,

similarly situated carriers using the same technology. This would afford CETCs the same options as rural ILECs and give them the same opportunity to avoid the administrative costs of developing an annual cost study.

While OPASTCO recognizes that cost accounting mechanisms for CETCs will take some time to develop, that does not mean that the identical support rule should remain in effect until the new cost reporting rules are ready for implementation. During the period of time in which accounting rules are being developed, the Joint Board should recommend the adoption of the interim plan filed by the Rural Telecommunications Associations in the FCC's proceeding on the Joint Board's Portability Recommended Decision.[11] Under this plan, wireless CETCs would receive a "safe harbor" percentage of the rural ILEC's per-line support, with the specific percentage determined by the size of the wireless carrier. The percentages established in the plan are based on the relative cost differences between wireline and wireless carriers as they currently exist. The percentages also acknowledge the fact that large wireless carriers that serve predominantly metropolitan areas and most likely benefit from economies of scale require less support than smaller, mostly rural wireless carriers.

Wireless carriers should be permitted to have their support determined by the safe harbor percentages established in the Associations' plan up until a certain sunset date, to be determined by the FCC. This would give wireless CETCs a transition period to internally adopt the cost accounting procedures established for them. After the sunset date, wireless CETCs would be required to adhere to the cost accounting rules (or use the average schedules) established for

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Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2005 (Nov. 2, 2004), Appendix HC01.

[11] *See*, Rural Telecommunications Associations comments in CC Docket No. 96-45 (fil. Aug. 6, 2004); Rural Telecommunications Associations reply comments in CC Docket No. 96-45 (fil. Sept. 20, 2004). The Rural Telecommunications Associations consist of OPASTCO, the Rural Independent Competitive Alliance (RICA), and the Rural Telecommunications Group (RTG).

them in order to receive support. Similar transitionary measures and sunset dates should be established for wireline CETCs and CETCs utilizing other technology platforms.

Even though it may presently be difficult for some CETCs to demonstrate their costs, this is not a legitimate reason for exempting these carriers from having to perform cost studies in order to qualify for support. Carriers that seek *high-cost* funding should be required to demonstrate that their costs are above average and exceed a certain threshold. Otherwise, the support they receive will most likely be more than just "sufficient," it will be excessive. The system needs to be accountable to those who ultimately fund it – ratepayers nationwide.