

**STATEMENT OF DENISE PARRISH
ON BEHALF OF THE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES**

REGARDING THE ISSUES OF HIGH-COST SERVICE SUPPORT FOR AREAS
SERVED BY RURAL CARRIERS AND RELATED ISSUES

*NOVEMBER 17, 2004
EN BANC HEARING OF THE FEDERAL-STATE JOINT BOARD
ON UNIVERSAL SERVICE*

Basic Principles

NASUCA very much appreciates the opportunity to provide input into the Joint Board's recommendation relative to high cost support funding for rural carriers. We agree that this review of the appropriate funding method is important and necessary. Yet, we urge the Joint Board to keep certain fundamental principles in mind as it undertakes the development of its recommendations. These principles, which are clearly spelled out in Section 254 of the Act, must not be lost in the discussions about today's market structures, new technologies, competitive by-pass, and growth rates. While each of those items has a place in the discussion, they are secondary to the fundamentals. These fundamental principles are beautifully simple in concept:

- affordability of basic communications services by all, including the economically disadvantaged;
- ubiquitous access to quality services throughout the nation;
- equitable and reasonably comparable treatment of urban and rural customers;

- a system of support that can be counted on to keep and better the high-quality and reliable telephone network that has been established throughout America; and
- a system of distributing support that neither advantages nor disadvantages emerging technologies or competitors in meeting basic communications needs.

The Joint Board need not select one of these principles at the expense of another. Rather, we believe the Joint Board can, and must, find a way to mesh each of these principles so that they become complimentary to one another. We hope our suggestions will assist the Joint Board in this formidable task.

NASUCA's Formal Comments

On October 15, 2004, NASCA filed formal comments in this matter. These comments encourage:

- the continued transition to economic costs by rural carriers that have 50,000 access lines or more through a five-year phase-in to a forward-looking cost basis of support;
- maintaining embedded costs, with checks and balances, as the basis of support for the smallest of the rural carriers;
- refinement of the definition of rural carrier including combining the entirety of the service area in a state for a carrier when determining its rural or non-rural status; and

- a leveling of the playing field such that CLECs receive support based on their own costs, rather than the costs of another carrier.

My comments are intended to be supplemental and complementary to those more formal and complete comments of NASUCA submitted in this matter.

What methodology should the Commission use to calculate the basis of support for eligible telecommunications carriers?

Does one size fit all?

Before determining the computational methods to be used in distributing support to ETCs, the Joint Board should consider whether *one size fits all* or whether there is justification to consider different support schemes for different sizes of carriers, different types of carriers, and carriers located in geographically diverse areas. We disagree with those who urge that one system can be made to fit all, whether the fit is natural or forced. However, in examining the general characteristics of carriers, including economies of scales, deployment costs, overheads, and other cost drivers, we conclude that three categories of carriers – and hence, three methods of computing support – are adequate and appropriate for today’s market.

Non-rural carriers should continue to be provided support on the basis of the Commission’s synthesis model that estimates forward-looking economic costs for each area of service throughout the nation. Rural carriers serving larger numbers of customers should be transitioned to a forward-looking cost method, but only if there is recognition

that the model and support mechanism needs modification and updating Rural carriers serving a smaller number of customers should be allowed to remain on an embedded cost based system, with some safeguards put in place to makes sure that the sky is not the limit in terms of federal support.

Redefining Rural

When placing carriers into one of our three recommended categories, we suggest that the characteristics of what constitutes a rural or non-rural carrier be redefined. Holding companies having multiple operations in one state should not be permitted to maintain separate study areas endlessly to the point of maximizing support. Holding companies are able to take advantage of their purchasing power and effectuate economies of scale relative to certain administrative and operating costs, as well as relative to the cost of material. In light of this, we encourage the redefinition of rural such that all of the related and subsidiary operations of a company are consolidated when performing the line count to determine if it qualifies as a small rural carrier, a large rural carrier, or a non-rural carrier. A new category of rural carrier should be created for those providers with more than 50,000 customers in a state.

In encouraging the consolidation of the multiple but related operations within a state for the purposes of defining rural carriers, we are not suggesting that these larger carriers may not need support. Their cost of providing service may still be driven upward by low-density service areas or rocky terrain. But, it is these actual cost characteristics

that should be recognized in the level of support they are provided rather than maintenance of artificial study area designations in order to maximize federal support.

NASUCA urges an additional refinement to the definition of rural carrier, for USF purposes. As just described, we encourage that rural carriers be defined as either larger rural carriers (those who serve a total of 50,000 or more lines in a state) or smaller rural carriers (those who serve less than 50,000 lines in a state). But, when determining whether a carrier is rural at all, the current definition should be narrowed. In looking at the current definition at Section 153(37) of the Act, a carrier is defined as rural if any one of several events listed occurs. For example, a carrier can have less than 15% of its access lines in communities of more than 50,000 on February 8, 1996 and be defined as rural, even though it may have several million total lines! To rectify this situation, NASUCA is recommending that Section 153(37) (B), (C), and (D) all apply for a carrier to be classified as rural. By making this change, there would be assurance that the territory served is rural and the carriers are smaller in total size. Once a carrier is defined as rural, it is then categorized as either a larger or a smaller rural carrier.

By redefining the characteristics of a rural carrier, the Joint Board, and ultimately the Commission, can better target the fund to those carriers with the highest need for support. Forward-looking cost models have currently proven to be the most problematic when attempting to measure the costs, customer locations and efficiencies of the most rural and smallest providers. By beginning additional transitions away from embedded-based support with the larger rural carriers, any problems that do exist will be minimized.

Furthermore, the costs of these larger rural carriers are more similar to those already being measured in the model for non-rural carriers than they are to the costs of the smaller, more high-cost, less dense rural carriers. Also, the costs of this larger rural carriers group appears to be more homogenous than are the costs of the smallest carriers.

The use of such a model to calculate the level of support to the carrier then blends the principles of providing support where it is needed (affordability) and minimization of the fund (sustainability). The model furthers the provision of quality services by using inputs based on modern technologies that allow for services that meet today's customers' expectations. Finally, the model would be technologically and competitively neutral since the model would reflect a reasonably efficient level of operations. This efficiency could then be achieved through the deployment of any one of multiple technologies. Assuming a proper measurement of the efficiencies and costs of today's carriers by the model, support should be predictable and sufficient.

Reexamining and Updating the Model Inputs

One key aspect of NASUCA's recommendation is that the model's inputs must be reexamined, revised, and updated during the five-year period we propose for transitioning larger rural carriers from an embedded cost system to a forward-looking cost system. We recommend that the current Commission synthesis model become the starting point for the development of a model for measuring appropriate distributions to the larger rural incumbent ETCs. We acknowledge and share the concerns of several of the Joint Board members that the model – as it stands today – does not work for either large or small rural

carriers. However, we are hopeful that with an update and reexamination of the customer locations, model assumptions on operating costs, and model assumptions on per unit investments, the results will provide the efficiency incentives that are intended while also providing sufficient support levels. NASUCA's support for a transition to forward-looking costs is dependent upon the re-look at the model inputs and assumptions. Without this provision, we too would continue to have serious doubts about the appropriateness of its use for any rural company – whether large or small.

Statewide Average versus Individual Carrier Costs

We also recommend a change in the granularity of the model outputs and the use of those outputs for making support distributions. Rather than expanding the current method of benchmarking against statewide average costs, we recommend that the forward-looking costs determined by the model for each carrier (based upon inputs representing individual carriers characteristics) be measured against a benchmark. If a carrier has more than one service territory in a state, those service areas would be combined for the purpose of determining distributions, but the costs for one carrier would not be combined with those of another provider when determining its share of high-cost support.

As to the benchmark against which an individual carriers' model output costs are to be applied, NASUCA has not yet made a recommendation. However, we do suggest that the Joint Board carefully examine whether the current benchmark for non-rural providers should also be applied to the rural carriers. Some updated model runs, some

average pricing information, and an examination of total rural customer bills (including more long distance than that used by most urban customers) would be useful as the Joint Board develops its recommendation on the appropriate benchmark for rural customers. Many continue to be concerned that the current benchmark for urban companies does not comply with the reasonable comparability test, and if this is true, we suspect that the reasonably comparable test would be even more compromised if the same benchmark were applied to rural companies. This is an area that needs more data and more discussion.

Small Carriers' Embedded Cost Support

NASUCA proposes that companies with fewer than 50,000 access lines remain under a support mechanism based on embedded costs for now. We also propose that further study should be done looking toward the ultimate transition of all companies to a forward-looking cost model. However, the transition of the smallest rural carriers from embedded-cost based support should only occur once re-examination and re-testing of the model with rural inputs and reasonable geographic customer data has been used in the forward-looking cost model. We must be assured that the support coming from such a transition will be sufficient to keep end user rates affordable and that the quality of service will not suffer. We must not become a nation of haves and have-nots for the sake of economic theory.

On the other hand, we agree that the current embedded system may offer opportunities for smaller companies to abuse the system through the use of gold-plating

networks or the lack of cost controls. Hence, we suggest that some there be some control placed on the level of overheads and administrative costs that are included in the computation of high-cost support. One method of doing this is by arriving at a *best-practices benchmark*. This benchmark could then become a safe-harbor where, for example, if a company's overheads were within a designated range, they would be deemed reasonable for inclusion in the support calculation. (The Joint Board should further examine the reasonable basis for such a benchmark, whether it be on a per customer basis, a dollar of revenue basis, a dollar of investment basis, or some combination thereof.) However, we are reluctant to endorse a system where all costs above such a benchmark are deemed to be unreasonable without even an opportunity for further explanation or support.

Should a competitor receive support based on the incumbent carrier's costs or its own costs?

Cost-Based Support for CETCs

NASUCA recommends that a CLEC receive support based on its own costs rather than based on the incumbent carrier's costs. Additionally, the CETC should only receive support if its costs are high enough to exceed the established benchmark such that support is necessary for it to continue to provide service in the rural market. It should not be entitled to receive high-cost support simply because another carrier receives such support. Experience has shown that support is not necessarily required to stimulate new investment in a rural market by a CETC, and thus, the support is simply a bonus revenue stream that is funded with customer money. Build-out often occurs, especially in rural

cellular markets, without any assurance that ETC status will be granted. If ETC status is granted, shareholders benefit but customers rarely, if ever, see a change in that competitive provider's price. Continuing to provide money to CETC's who show no need for the funds fails the test of providing a sustainable fund. It also fails the test of maintaining affordable rates for all customers as customers are required to pay more and more to support a fund that is growing unnecessarily.

Some may argue that requiring CETC's to provide cost data in order to receive public support is a move toward heavy-handed regulation and away from free-market economics. We disagree. The NASUCA proposal relative to fund distributions *would not require* a competitive carrier to provide any cost data to regulators and would not require any regulatory approvals *unless* it was asking for money that is coming from a publicly administered pool of money funded by all customers – not just its own. If a company is to receive high-cost funds, it should be willing to show it has a need for the money and that providing such funds is not in violation of the public interest. If it chooses not to share such information, it should fund its operations from shareholder money and revenues from its own customers.

We recommend one other computational limitation on the support provided to CETCs. Support must be capped at the incumbent carrier's level of support in order to ensure a sustainable high-cost program and mitigate the risk of uneconomic support for very high-cost competitive carriers. ILECs continue to serve as the only reliable carrier of last resort. If a competitive provider is unable to offer services at a cost equal to or less

than the costs incurred by the incumbent provider, it is not in the public interest to support that provider's higher costs. Competition is not served by allowing inefficient competitive providers to remain in an area at the expense of the American public. Competitive providers should not receive support that exceeds the per line support provided to the incumbent carrier.

The universal service fund should not be used to advance or promote competitive carriers market entry. It should be competitively neutral which means that it should neither advantage nor disadvantage any carrier serving the market. Providing an incentive for the inefficient carrier to enter the market is not competitively neutral but instead advantages the CETC. This practice should stop.

What level of support should be provided to carriers who acquire exchanges from an unaffiliated carrier?

NASUCA did not take a position on this question in its October 15, 2004 comments. However, several principles stated in response to other aspects of the Joint Board's questions are also applicable in response to the issue of support for acquired exchanges. Carriers should not be provided an incentive to purchase exchanges just to increase their profit levels at the expense of the high-cost fund. But, if exchanges purchased are deemed to be in the public interest (in that quality of service will improve, affordability and accessibility of services will increase, or other fundamental public interest standards are met) then they should receive similar treatment as existing

exchanges. Administrative cost safeguards would be applied. Consolidation of study areas within a state would occur for purposes of computing high-cost support. Rates and services should continue to be subject to the reasonably comparable test.

Again, NASUCA is appreciative of the opportunity to provide input into this proceeding. We look forward to answering any questions you may have about our recommendations at the en banc hearing.