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

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| In the Matter of | ) | |
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| Federal-State Joint Board on Universal Service; High-Cost Universal Service Support | ) | WC Docket No. 05-337 |
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# Comments of Frontier Communications on Use of Reverse Auctions

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## INTRODUCTION AND SUMMARY

Frontier Communications ("Frontier")[1] hereby submits its comments in the above captioned matter pursuant to the Joint Board's August 11, 2006 Public Notice.[2] Frontier strongly opposes the suggestion that high cost universal service funding should be subjected to any kind of competitive bidding. As will be shown below, such a mechanism would directly contradict the statutory requirement that universal service support be both predictable and sufficient, would reduce investments in rural areas, and would be likely to devastate the very companies that universal service funding was designed to support, with a corresponding loss of rural jobs and a reduction of service to rural America.

Frontier is concerned that the focus of the Joint Board appears to be moving toward a goal of minimizing the size of the fund rather than ensuring universal service. While controlling

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[1] Frontier is a mid-size holding company with incumbent local exchange carrier (ILEC) operations in 23 states. As an ILEC, Frontier operates in one of the most competitive (both residential and business) urban markets in the country (Rochester, NY), but the balance of its ILEC operations are located in several small, high cost rural markets throughout the United States. In most of its ILEC markets, Frontier operates under federal price cap regulation, but operates under NECA Average Schedules in some of its smallest rural markets; on an intrastate basis, Frontier mostly operates under a mix of traditional rate-base, rate-of-return regulation and alternative forms of regulation. This somewhat unique mix of size, industry segment, geographic scope and business conditions allows Frontier special insights into the major issues confronting the Federal Communications Commission (the "Commission") and the industry in regard to intercarrier compensation and universal service.

[2] Public Notice, FCC 06J-1 (released August 11, 2006).

the size of the fund is certainly a worthy goal, this goal must take second place to the statutory policy of preserving and advancing universal service.

Rather than minimizing the size of the fund by reducing universal service, the Joint Board and the Commission should instead control the size of the fund by establishing a separate fund for Competitive Eligible Telecommunications Carriers ("CETCs"), by giving them recovery based on their own costs, not ILEC costs, by limiting the number of CETCs in any given study area, and by establishing mandatory service-related CETC certification requirements.

## I. REVERSE AUCTIONS WOULD VIOLATE §254(b).

As stated in the Public Notice, the operative statute, 47 U.S.C. §254(b)(5), requires that the mechanisms to preserve and advance universal service be "specific, predictable and sufficient … to preserve and advance universal service." Frontier submits that reverse auctions would violate the requirements of predictability and sufficiency.

By definition, the results of an auction are unpredictable. If the result of the auction determines, as proposed, the amount of support, then by definition the amount of support is unpredictable. In addition, it would be wholly impractical to attempt to design an auction mechanism that would permanently determine the amount of support. As a result, a series of auctions would be required on some kind of periodic cycle. Thus, because of the uncertainty of auction results in advance, and because of the necessity of periodic ongoing auctions, the amount of universal service support would never be predictable, except for the short period of time between one auction and the next.

The statute does not permit the universal service support mechanism to be "occasionally predictable" or "periodically predictable." The mechanism must be "predictable." Switching and loop plant installed to serve rural customers in many cases will be in service for decades, and

the depreciable life of most plant facilities exceeds 10 years. If universal service support is not reasonably predictable over the period during which a company investing in plant will recover its costs, then Frontier submits that the mechanism fails the predictability test.

Neither can it be remotely assured that the results of a reverse auction would be "sufficient … to preserve and advance universal service" as required by §254(b)(5). State commissions and the Commission have in recent years been more than ready to certify cellular carriers as CETCs in rural ILEC territories.[3] With a reverse auction, the results are likely to be only "sufficient" to satisfy the lowest cost ETC. If the lowest cost ETC does not require support, then the bids in a competitive situation would be likely to produce only a minimal amount of support or no support at all. Cellular costs to cover an area are typically lower than landline costs, and of course there are tradeoffs – a correspondingly lower quality of voice transmission, areas of incomplete coverage due to cell site locations and terrain, a frequently higher price for service and a substantially lower amount of bandwidth per customer available for the provision of broadband services. It may be expected, if the reverse auction players were to behave economically, that the bid amount would be just sufficient to provide cellular carriers an incentive to serve the area in question, but insufficient to provide a reasonable return on a rural ILEC's existing investments and far short of what would motivate the ILEC to make any new investments in landline services.

In the long run there are only two possible results from this kind of auction scenario where cellular carriers would bid against rural ILECs. The first alternative is that the rural ILEC would eventually go out of business, leaving customers with spotty and expensive cellular service as their only telephone service. This is hardly "sufficient" and it would further violate the

[3] Cellular carriers as a general matter do not actually need high cost funding to enter rural markets. Some large cellular carriers do not even request ETC status. In addition, in almost every case, the cellular carriers applying for ETC status have already entered the market, in many cases for a number of years previous to their applications. If they do not need the funding to enter a market, these carriers may confidently be expected to bid low in a reverse auction.

principle of "quality services … at just, reasonable and affordable rates." 47 U.S.C. §254(b)(1). The second alternative is that the rural ILEC would have to raise its rates substantially to make up its loss of support, thus defeating the entire purpose of universal service support by driving its lower income customers off the network, and violating the principle of "access to telecommunications services and information services … at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. §254(b)(3). In neither case would a reverse auction provide support that is sufficient to preserve and advance universal service.

## II. REVERSE AUCTIONS WOULD REDUCE RURAL INVESTMENT.

If a company cannot reasonably expect a return on and a return of its investment, it will not make the investment in the first place. It would be gambling with their owners' money for rural ILECs to invest any money in expectation of winning a series of future auctions.[4] The only reasonable assumption that prudent ILEC managers could make would be an assumption of no support, nor could prudent ILEC managers count on large future rate increases to cover their lost support.

Every ILEC has alternative uses for its capital other than investing in new or upgraded rural telecommunications plant. At the very least, one option is to return money back to the owners of the firm if it cannot be invested economically. Another is to invest in other, more profitable lines of business. The losers in this scenario would be rural telephone customers. In the absence of reasonably foreseeable economic returns on investment, rural ILECs would be motivated to invest only the amount of capital required to provide the bare minimum levels of

[4] A transition mechanism for ILECs would not cure this problem. Unless the transition lasts as long as the asset, recovery of the ILEC's investment is unpredictable. And even if the transition were initially designed to last as long as an asset, within a year or two that would no longer be the case with respect to new investments, because the remaining transition period would be shorter every year.

service availability and quality. Absent large rate increases, even these minimal investments would be of questionable profitability. Any amount of universal service support actually received through the auction process would of course be welcome, but because it could not be counted upon it would not be the basis of investment decisions.

Reverse auctions would affect not only a rural ILEC's use of its existing capital, but also its ability to attract third party capital. Often ILECs do not have the cash on hand to make investments, and they must turn to the capital markets to obtain debt financing. If reverse auctions were implemented, potential lenders would have far less security in terms of the cash flows that an investment might reliably be expected to generate. The assets themselves, once installed, are worth little more than scrap value except to the extent that they can generate reliable cash flows. In the absence of predictable and adequate high cost support, ILECs may be unable to make a sound enough business case for a third party to loan money for the investments that they would otherwise make in providing and maintaining universal service in rural America. There is no doubt that the rural ILECs' cost of debt would significantly increase for any debt that they could obtain.

## III. REVERSE AUCTIONS COULD HAVE A DEVASTATING EFFECT ON RURAL ILECS AND THEIR COMMUNITIES.

The reduction in rural investment that would be caused by reverse auctions and the corresponding lack of predictability and sufficiency of support could devastate rural ILECs and their communities. Reduced rural telecommunications investment and the inevitable corresponding slide toward a bare minimum level of service would have ripple effects throughout rural America. New investments by rural ILECs translate directly into jobs to support the construction, operation and maintenance of the new plant. These jobs would be lost. Communities would be unable to attract or retain employers requiring the latest

telecommunications services, because the services would not be there. Increased ILEC rates would drive people off the network. All of these are the very results that universal service funding is supposed to be designed to avoid.

At the very least, the impact of uncertain and drastically reduced support would cause an immediate and permanent decline in the market value of rural ILECs and possibly render many of them unmarketable. Ultimately, the loss of high cost support could drive rural ILECs out of business. If a cellular CETC were to win a reverse auction and do so consistently, presumably it and not the ILEC would be the carrier of last resort. The ILEC might well be unable to obtain rate increases to offset its lost support, because of reluctance on the part of regulators to approve massive increases or the simple inability of its customers to afford the increases. Under these circumstances it might be economically prudent for the ILEC to liquidate its investment as far as possible and exit the market, leaving a cellular CETC as the sole supplier of service. The impact on the community would be severe. It would lose a large local business and employer, the telephone company that has provided service in some cases for over a century. And it is unlikely that any large businesses would move to, or even stay in, a community where the only telephone service is wireless.

These results are not overblown doomsday scenarios. They are readily foreseeable and even probable results for many companies if the Joint Board and the Commission decide to kick away one of the most important supports of universal service.

## IV. THE JOINT BOARD SHOULD RECOMMEND A SEPARATE HIGH COST FUND FOR CETCs BASED ON THEIR OWN COSTS.

The impact of reverse auctions would be to drag high cost support for rural ILECs down to the lowest common denominator, which would probably be the amount of funding required to give a cellular CETC an incentive to serve a rural exchange. In fact, the proposal would drop a

rural ILEC's support down to zero unless it successfully underbid the CETCs in the area in question, which could include multiple cellular carriers. Rather than controlling the size of the fund by damaging rural ILECs, the Joint Board should consider controlling the size of the fund by ending the current "gravy train" for CETCs.

There is no good public policy reason to continue to give CETCs support based on the costs of the ILECs. There is no evidence that support at the ILEC level is necessary to provide an incentive for CETCs to enter rural markets. To the contrary, CETCs generally enter the markets in question before they seek CETC certification, and a number of carriers do not seek certification at all. Handing CETCs support at the ILEC level merely provides a windfall at the expense of all end users of interstate services, who ultimately bear the costs of the fund. Exacerbating the situation is the possibility of many wireless CETCs in the same study areas, all drawing support at the ILEC level. It is no surprise that there is a concern about the overall size and ultimate viability of the fund under the current rules. Frontier submits that the future growth in the size of the fund required for high cost support is being driven by CETCs, not ILECs.

Based on first quarter USAC statistics, the following points bear this statement out:

- Wireline funding:
  - is capped by the Commission;
  - grew only 1.4% from 2000-2005;
  - is based on ILECs' actual investments and expenses;
  - is subject to audit; and
  - is actually declining for some rural carriers.
- Wireless or CETC funding:
  - is uncapped;
  - is experiencing unmitigated growth, 193% compounded, from 2003-2005;
  - will exceed $1 billion in 2006; and
  - is not subject to audit because it is based on the incumbent's support.

Frontier proposes a separate high cost fund for CETCs,[5] from which they would draw based on their own costs, not ILEC costs. The benefits from this proposal would go beyond reducing the size of the fund by eliminating an unnecessary windfall. USAC and the FCC would have a much clearer picture of what funding levels and possibly what caps may be necessary or appropriate for CETCs as opposed to ILECs. It would also be easier to scrutinize, audit and control the size of the fund by focusing on the CETCs' needs rather than mixing them in with the ILECs.

## V. THE COMMISSION SHOULD LIMIT THE NUMBER OF CETCS IN ANY GIVEN HIGH COST STUDY AREA AND SHOULD ESTABLISH MINIMUM CETC GUIDELINES.

The Joint Board should recommend to the Commission other measures that would limit the growth in the Universal Service Fund without damaging universal service.

First, there should be a limit to the number of CETCs in any given study area. For example, there is no public interest served if five or six wireless carriers, all of whom are expanding coverage anyway, draw universal service support in a single area. Realistically, there do not need to be large numbers of carriers of last resort. Frontier suggests that no more than two CETCs, in addition to the ILEC, should be approved in any given study area that obtains high cost support.

Second, there is a perfectly reasonable and rational political consideration that may be affecting state regulatory decisions to certify new CETCs. That consideration is the simple fact that contributions to the Universal Service Fund are made on a national basis, while high-cost support is paid on a study area basis. To put it more bluntly, additional high cost support funding means that money is flowing from the nation into the state in question. This

[5] Frontier only proposes a separate CETC high cost fund for accounting and tracking purposes, not a separate cost recovery mechanism or surcharge.

consideration may lead state regulators to give more weight in their decisions to the state's public interest in increased economic activity than to the importance of controlling the size of the fund. Accordingly, Frontier suggests that the Commission should establish mandatory certification requirements, to ensure that CETCs meet a minimum set of qualifications before they start drawing from the fund.

In the Report and Order in *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 20 FCC Rcd 6371 (released March 17, 2005) ("Report and Order"), the Commission declined at that time to establish mandatory requirements for the state commissions to use to designate ETCs.[6] Although the Commission in the Report and Order noted the states' authority to designate ETCs, nothing in §214(e)(2) of the Act restricts the Commission's authority to interpret §214(e)(1) of the Act to define the "services that are supported by Federal universal service support mechanisms". The Commission should establish minimum service-related requirements to ensure that the ETCs designated by the states offer services that are appropriate for universal service funding, subject to state authority under §214(e)(2) to establish additional requirements in the public interest.

The Commission's existing guidelines serve as an appropriate starting point. Each of the current guidelines relates to the determination of what services should be supported by high cost funding. The guidelines for state commissions require a prospective CETC to demonstrate:

> (1) a commitment and ability to provide services, including providing service to all customers within its proposed service area; (2) how it will remain functional in emergency situations; (3) that it will satisfy consumer protection and service quality standards; (4) that it offers local usage comparable to that offered by the incumbent LEC; and (5) an understanding that it may be required to provide equal access if all other ETCs in the designated service area relinquish their designations pursuant to section 214(e)(4) of the Act.[7]

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[6] Report and Order, ¶61.

[7] Report and Order, ¶20.

In addition, the Joint Board should consider, and should recommend to the Commission, other mandatory service-related certification requirements that would help avoid an uncontrollable growth in funding requirements. Candidates for such requirements that should be considered further are coverage of the entire ILEC study area, full equal access, acceptance of carrier of last resort responsibilities, and a simple, low-cost local-only service offering. The states would remain free to define any additional requirements to satisfy the public interest requirement.

**CONCLUSION**

For the reasons stated herein, the Joint Board should reject the proposal of reverse auctions for high cost support and instead should recommend controlling the growth of the fund by establishing a separate high cost fund for CETCs based on their own costs and needs, a limitation of the number of CETCs in any given study area, and mandatory CETC certification requirements.

Respectfully Submitted,

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Date: October 10, 2006

## CERTIFICATE OF SERVICE

I, Gregg C. Sayre, do certify that on October 10, 2006, the aforementioned ***Comments of Frontier Communications on Use of Reverse Auctions*** were electronically filed with the Federal Communications Commission through its Electronic Comment Filing System and were electronically mailed to the following:

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