

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

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

---

**REPLY COMMENTS OF  
THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES,  
MAINE OFFICE OF THE PUBLIC ADVOCATE,  
AND THE NEW JERSEY DIVISION OF RATE COUNSEL**

---

Charles Acquard, Executive Director  
NASUCA  
8380 Colesville Road, Suite 101  
Silver Spring, MD 20910  
Phone (301) 589-6313  
Fax (301) 589-6380

William C. Black  
Deputy Public Advocate  
Wayne R. Jortner  
Senior Counsel  
Maine Office of Public Advocate  
SHS#112

Augusta, ME 04333  
Phone (207) 287-2445  
Fax (207) 287-4317

Stefanie A. Brand  
Director  
Division of Rate Counsel  
Christopher J. White  
Deputy Rate Counsel  
P.O. Box 46005  
Newark, NJ 07101  
Phone (973) 648-2690  
Fax (973) 624-1047  
[www.rpa.state.nj.us](http://www.rpa.state.nj.us)  
[njratepayer@rpa.state.nj.us](mailto:njratepayer@rpa.state.nj.us)

Regina Costa  
Telecommunications Research Director  
TURN  
115 Sansome St., Suite 900  
San Francisco, CA 94104  
Ph. (415) 929-8876  
Fax (415) 929-1132  
[rcosta@turn.org](mailto:rcosta@turn.org)

February 15, 2012

## TABLE OF CONTENTS

	Page #
SUMMARY .....	ii
I. INTRODUCTION .....	1
II. CARRIER OF LAST RESORT .....	2
The FCC should deny unambiguously carriers' calls to be relieved of their "legacy" carrier of last resort obligations, and, in no event, should the FCC pre-empt states' policies and rules regarding carrier of last resort obligations. ....	2
III. BROADBAND PRICING AND REGULATION .....	5
A. The FCC should monitor broadband pricing data and should reject industry's recommendation to rely on private sources and industry's website for information.....	5
B. The FCC should monitor carriers' interconnection practices and require nondiscriminatory conduct relative to their competitors. ....	7
IV. INTERSTATE RATE-OF-RETURN REPRESCRIPTION .....	8
A. Rate of Return Analysis .....	8
B. The Budget Constraint, Sufficient Support and Revenue Benchmark .....	12
C. Establishing constraints on annual expenses .....	14
D. Broadband Specific Service Measurements and Reporting Requirements.....	15
V. CONCLUSION.....	16

## SUMMARY

The National Association of State Utility Consumer Advocates (“NASUCA”), the Maine Office of the Public Advocate, the New Jersey Division of Rate Counsel (“Rate Counsel”), and The Utility Reform Network (“TURN”) (collectively, “Consumer Advocates”) respond to several comments on selected issues in the Further Notice of Proposed Rulemaking, and may address other topics in a future *ex parte* filing. Silence on particular matters, however, should not necessarily be construed as agreement with other commenters. Also, Consumer Advocates do not repeat the various analyses and recommendations that are set forth in initial comments.

In these reply comments, Consumer Advocates urge the FCC to reject carriers’ requests to be relieved of “legacy” obligations. Consumer Advocates also urge the FCC to reject carriers’ proposal that the FCC rely on third-party sources for broadband pricing information (in lieu of requiring carriers to submit information directly to the FCC). Furthermore the FCC should require carriers to offer nondiscriminatory interconnection to their rivals; and the FCC should monitor closely the rates, terms, and conditions of broadband services in order to detect and prevent supracompetitive pricing and practices. Finally, Consumer Advocates urge the FCC to lower the prescribed rate of return for rate-of-return carriers.<sup>1</sup>

---

<sup>1</sup>/ Susan Baldwin and Dr. Robert Loube provided substantial contributions to the analysis and drafting of these reply comments.

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

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

---

**REPLY COMMENTS OF  
THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES,  
MAINE OFFICE OF THE PUBLIC ADVOCATE,  
AND THE NEW JERSEY DIVISION OF RATE COUNSEL**

---

**I. INTRODUCTION**

The National Association of State Utility Consumer Advocates (“NASUCA”) as an organization, and NASUCA members the Maine Office of the Public Advocate and the New Jersey Division of Rate Counsel (“Rate Counsel”), The Utility Reform Network (“TURN”) (collectively, “Consumer Advocates”) hereby submit brief reply comments regarding selected issues in response to the Further Notice of Proposed Rulemaking (“Notice”) released by the

Federal Communications Commission (“FCC” or “Commission”),<sup>2</sup> specifically regarding the issues that the FCC identifies in Sections XVII.A through XVII.K of the Notice.<sup>3</sup>

## II. CARRIER OF LAST RESORT

**The FCC should deny unambiguously carriers’ calls to be relieved of their “legacy” carrier of last resort obligations, and, in no event, should the FCC pre-empt states’ policies and rules regarding carrier of last resort obligations.**

The FCC should deny unambiguously carriers’ calls to be relieved of their “legacy” obligations.<sup>4</sup> For example, Verizon opposes the continuation of the federal voice service obligation because, according to Verizon, the Commission would violate section 214 by perpetuating eligible telecommunications carrier (“ETC”) obligations for carriers that do not receive legacy high cost support or CAF support;<sup>5</sup> and “forcing an unsupported competitor to provide service at a loss in competition with a CAF recipient would violate both the Takings Clause and Section 254’s mandate that universal service policies be ‘equitable and nondiscriminatory.’”<sup>6</sup> Verizon’s reasoning is flawed on both counts. If Verizon’s proposal were

---

<sup>2</sup>/ *In the Matter of Connect America Fund*, WC Docket No. 10-90; *A National Broadband Plan for Our Future*, GN Docket No. 09-51; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Lifeline and Link-Up*, WC Docket No. 03-109; *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, released November 18, 2011. In these comments, references to the Report and Order are cited as “Order” and references to the Further Notice of Proposed Rulemaking are cited as “Notice.” Consumer Advocates submitted initial comments on January 18, 2012.

<sup>3</sup>/ Consumer Advocates have reviewed selected initial comments, specifically the following: Ad Hoc Telecommunications Users Committee (“Ad Hoc”); AT&T; California Public Utilities Commission and the People of the State of California (“California PUC”); CenturyLink; Time Warner Cable Inc. (“Time Warner”); Verizon; and the National Exchange Carrier Association, Inc., the National Telecommunications Cooperative Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies, and the Western Telecommunications Alliance (“Rural Associations”).

<sup>4</sup>/ See, e.g., Verizon, at 2-18; AT&T, at 3-17; CenturyLink, at 9-10.

<sup>5</sup>/ Verizon, at 4.

<sup>6</sup>/ *Id.* at 5.

adopted, it would mean that not only could carriers receive support for their *high-cost* geographic areas, but they also would be able simultaneously to abandon obligations for their *low-cost* areas, or indeed any areas of their unilateral choosing. Furthermore, carriers would have virtually unfettered discretion to determine which areas to serve. Verizon’s proposal is lopsided because it focuses on carriers’ legacy *obligations* without acknowledging or compensating consumers for the legacy *advantages* that incumbent carriers uniquely possess, advantages that have accrued to them for decades as a direct result of the regulatory bargain. Carriers have been able to deploy ubiquitous networks as a direct result of their historic access to consumer-generated revenues, and, moreover, are now able to generate substantial *unregulated* revenues from services offered over these networks (broadband services, and, under many state regulatory frameworks, discretionary services). By emphasizing the purported cost and burden of legacy obligations without acknowledging the substantial revenues, century-long customer relationships, and unparalleled brand recognition (which also uniquely benefit carriers’ broadband and wireless affiliates), carriers depict a distorted view of the overall cost and benefit of being a “legacy” carrier.

Similarly, AT&T requests that the Commission “clarify” that ETCs do not have legacy ETC obligations where they do not receive federal high-cost support,<sup>7</sup> and asserts that the Commission should “immediately sunset all ETC service obligations for those ETCs providing service in geographic areas that are ineligible for high-cost support.”<sup>8</sup> CenturyLink recommends that wherever legacy high-cost support is reduced or eliminated, ETC voice service obligations

---

<sup>7</sup>/ AT&T, at 3.

<sup>8</sup>/ *Id.* at 6.

should also be reduced or eliminated.<sup>9</sup> However, the incumbent carriers have failed to quantify or to substantiate the purported cost to them associated with fulfilling legacy obligations.

Consumer Advocates also disagree with Verizon's assertion that purportedly widespread access to voice services makes legacy ETC service obligations obsolete.<sup>10</sup> Where households have a competitive "choice," it is typically for an offering such as a bundled cable offering or a wireless offering that is substantially higher-priced or possibly less reliable than an incumbent carrier's stand-alone basic service.<sup>11</sup> These cannot be considered economic substitutes.

Consumer Advocates strongly oppose Verizon's proposal that the Commission adopt a rule that an ETC's service area would be limited to those specific areas where the ETC receives universal service support and that states would be bound by the Commission's rule when defining ETC service areas.<sup>12</sup> Instead, as stated in initial comments, Consumer Advocates commend the FCC's decision in the Order to reject calls to preempt state-mandated voice service obligations.<sup>13</sup> The FCC found that the supporters of preemption had failed to show that any specific obligations were unfunded mandates that would harm broadband deployment or to show that the obligations were inconsistent with federal rules.<sup>14</sup> The FCC must protect the goals of

---

<sup>9</sup>/ CenturyLink, at 9.

<sup>10</sup>/ Verizon, at 9-11. Consumer Advocates have demonstrated the lack of affordable alternatives to carriers' stand-alone residential service in other filings to the FCC and do not repeat all of the arguments and evidence here.

<sup>11</sup>/ Among other things, Verizon points to the nearly 60 percent of households ages 25 to 29 that are wireless only. Verizon, at 11. Verizon's prediction that this number will rise "because young adults are the most likely to rely on communication alternatives" (*id.*), does not alter *today's* demographics. Older adults are much less likely to "cut the cord." Nationally, 34.3.0% of adults aged 35-44 years; 21.6% of adults aged 45-64 years; and 7.9% of adults aged 65 years and over lived in households that relied solely on wireless telephones in the first six months of 2011. Stephen J. Blumberg, Ph.D., and Julian V. Luke, Division of Health Interview Statistics, National Center for Health Statistics, *Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, January-June 2011*, rel. December 21, 2011, at 8.

<sup>12</sup>/ *Id.*

<sup>13</sup>/ Order, at para. 82.

<sup>14</sup> *Id.*



preserving and advancing universal voice service (and ensure that such service remains reliable and affordable) even as the Commission pursues broadband deployment.

### **III. BROADBAND PRICING AND REGULATION**

#### **A. The FCC should monitor broadband pricing data and should reject industry's recommendation to rely on private sources and industry's website for information.**

The prices that broadband suppliers charge, as well as the terms, and conditions of their service, shed light on the status of competition in relevant geographic markets, and, furthermore, directly influence the rate of broadband adoption by households, particularly those with limited incomes. Most consumers have at most two broadband suppliers – the incumbent telecommunications carrier and the incumbent cable company. This duopoly does not represent effective competition. Moreover, several cable companies have entered into commercial agreements with Verizon Wireless to cross-market their services, which, by facilitating cooperation among the nation's largest telecommunications and cable companies, will further constrain effective competition in broadband markets.<sup>15</sup> In the context of this highly concentrated broadband market, the FCC should be diligent in monitoring broadband prices.

Verizon reiterates its oft-repeated recommendation that the FCC should rely on private sources of information and companies' web sites for information about broadband pricing.<sup>16</sup> Consumer Advocates continue to urge the Commission to reject this unsound recommendation, and to reject proposals that the FCC rely on other parties such as private analysts for pricing

---

<sup>15/</sup> For example, Comcast, Time Warner, and Bright House have entered into separate commercial agreements with Verizon Wireless under which the companies "will sell each other's services on a market-standard commission basis, with the new subscribers becoming customers of the other service provider (i.e., wireless customers signed up by the cable companies would become customers of Verizon Wireless, and cable companies signed up by Verizon Wireless would become customers of the cable companies)." *In the Matter of Application of Cellco Partnership d/b/a Verizon Wireless and SpectrumCo LLC For Consent To Assign Licenses*, WT Docket No. 12-4, Verizon Wireless/SpectrumCo Public Interest Statement, at 23-24.

<sup>16/</sup> Verizon, at 18-21.

information.<sup>17</sup> Furthermore, the very “complexity” of wireless pricing data that Verizon describes<sup>18</sup> justifies the collection and reporting of data by the FCC, an agency with the requisite expertise to sort through and make sense of these industry-created complexities.

Furthermore, Consumer Advocates concur with Ad Hoc’s recommendation that the Commission should not rely on the market to yield rates for broadband service that will encourage broadband adoption.<sup>19</sup> The Commission has not been provided evidence of market place conditions that would prevent duopolists from charging supracompetitive rates for broadband services.<sup>20</sup> Furthermore, Consumer Advocates concur that the “obligation to ensure the reasonableness of rates for services that are infused with the public interest and that are not provide under competitive conditions is one of the Commission’s most important obligations.”<sup>21</sup> Related to the fulfillment of that obligation is the need to collect relevant data and to make it publicly available, as well as to change past decisions, as market conditions so warrant, regarding broadband regulation.<sup>22</sup>

Furthermore, in initial comments, Consumer Advocates observed that it is not evident why, although the FCC requires CAF recipients to offer standalone voice service, the FCC does not also require CAF recipients to offer standalone broadband service.<sup>23</sup> Ad Hoc also suggests that the Commission could consider requiring broadband providers to unbundle telecommunications and broadband services.<sup>24</sup> The ubiquitous industry practice of tying the

---

<sup>17</sup>/ *Id.* at 19.

<sup>18</sup>/ *Id.* 20-21

<sup>19</sup>/ Ad Hoc, at 12-13.

<sup>20</sup>/ *Id.*

<sup>21</sup>/ *Id.* at 14.

<sup>22</sup>/ *Id.* at 14-15.

<sup>23</sup>/ Consumer Advocates, at 6, citing Order, at para. 80, and at footnote 127.

<sup>24</sup>/ Ad Hoc, at 14.

price or availability of broadband service to voice service subscription hinders a competitive market and drives up prices for ordinary consumers who should be able to freely shop for services in each separate market.

Consumer Advocates reiterate their support for the FCC's adoption of a uniform reporting format to facilitate the tracking and review of broadband measurement reports, and also support recommendations to require carriers to provide information in a Geographic Information System format, which will facilitate updates to national and state mapping of broadband availability.<sup>25</sup>

**B. The FCC should monitor carriers' interconnection practices and require nondiscriminatory conduct relative to their competitors.**

Consumers benefit from regulatory policies and oversight that promote diverse broadband supply. Therefore, Consumer Advocates support Time Warner's recommendation that the Commission condition the receipt of CAF support on an ETC's commitment to provide nondiscriminatory interconnection to competing carriers.<sup>26</sup> An unambiguous FCC commitment to nondiscrimination combined with timely dispute resolution will minimize costly and timely interconnection disputes that only serve to delay the development of competitive alternatives in broadband markets. If incumbent carriers refuse to interconnect with their rivals, they can discourage unsubsidized entry into broadband markets, thereby causing the universal service funding requirements to be higher than they otherwise would be, which, in turn, unduly burdens consumers, who pay for universal service support.<sup>27</sup> Although Consumer Advocates support a baseline requirement that CAF recipients interconnect with rivals on nondiscriminatory terms,<sup>28</sup>

---

<sup>25</sup>/ See California PUC, at 2.

<sup>26</sup>/ Time Warner, at 3-9.

<sup>27</sup>/ *Id.* at 6-7.

<sup>28</sup>/ *Id.* at 3-9.

Consumer Advocates would prefer that *all* carriers, regardless of whether they receive CAF support, be required to interconnect with reasonable rates, terms and conditions.

Anticompetitive conduct harms consumers and thwarts the Commission's broadband goals.

#### **IV. INTERSTATE RATE-OF-RETURN REPRESRIPTION**

Consumer Advocates hereby respond to certain comments filed by the Rural Associations. While Consumer Advocates recognize and appreciate many of the concerns that the Rural Associations have with the Order and the Notice, Consumer Advocates disagree with the specific approach and proposals advocated by the Rural Associations. Consumer Advocates do not agree with the Rural Associations' rate of return analysis; the Rural Associations' approach to meeting the FCC budget constraint; the Rural Associations' opposition to the establishment of expense constraints; and the Rural Associations' failure to recognize the need for reporting and measurement standards.

##### **A. Rate of Return Analysis**

The Rural Associations support the use of a weighted average cost of capital ("WACC") of 11.48%. This value is estimated based on the average of two cost of equity estimates, 12.55% based on the Discounted Cash Flow ("DCF") method and 14.15% based on the Capital Asset Pricing Model ("CAPM"); a cost of debt of 4.42%; and a market-based capital structure of 79.06% equity and 20.94% debt. These values were supported in the affidavit of Dr. Randall S. Billingsley attached to the Rural Associations' comments.

Dr. Billingsley relied heavily on the findings in the 2003 *Virginia Arbitration Order* to support his analysis.<sup>29</sup> The Virginia Arbitration proceeding is the most recent proceeding in which the FCC addressed the issue of cost of capital, and Consumer Advocates agree that it is the proceeding that should give guidance to the determination of the cost of capital.<sup>30</sup> Dr. Billingsley, however, incorrectly interprets that order, and therefore his analysis should be rejected.

Dr. Billingsley suggests that the DCF estimate of the cost of equity is 12.55%. A DCF estimate is the sum of the dividend yield and the estimate growth rate of dividends. Given that dividend yields are approximately 3%,<sup>31</sup> a 12.55% cost of equity implies that the dividend growth rate is over 9%. However, in the Virginia Arbitration Order, it was recognized that it is impossible for the dividend growth rate to be higher than the nominal growth of the economy.<sup>32</sup> Given that current forecasts of the nominal growth rate of the economy are approximately 4.6%, a dividend growth rate of greater than 9% is unreasonable and therefore, Dr. Billingsley's DCF estimate must be dismissed.

Dr. Billingsley's alternative cost of equity is based on the CAPM. The CAPM estimate is equal to the risk free interest rate plus the product of the Beta and the risk premium. Dr. Billingsley used the current long-term Treasury Bond interest rate of 2.7% as the risk-free rate and a Beta of .89. The Treasury Bond rate is a reasonable estimate for the risk-free rate and a

---

<sup>29/</sup> *In the Matter of Petition of Worldcom, Inc. Pursuant to Section 252(e)(5) of the Communication Act for Preemption of the jurisdiction of the Virginia State Corporation Commission Regarding Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No 00-218, Memorandum Opinion and Order, DA 03-2738, released August 29, 2003 ("*Virginia Arbitration Order*").

<sup>30/</sup> It must be noted that the FCC Commissioners did not directly approve the Virginia Arbitration decision. Rather it was adopted on the basis of the recommendation of the Chief of the Wireline Competition Bureau.

<sup>31</sup> The current average dividend yield of the 398 stocks included in the S&P 500 that have non-zero dividends is 2.51%. <http://indexarb.com/dividendYieldSortedsp.html>.

<sup>32/</sup> *Virginia Arbitration Order* at 73.

Beta of .89 is similar to other Betas supported in this proceeding.<sup>33</sup> However, the estimate of the risk premium, 11.12%, is unacceptably high. It is based on the difference between an estimated DCF equity rate for the Standard and Poor 500 Index of 13.84% and the Treasury Bond rate of 2.7%.<sup>34</sup> The Standard and Poor 500 Index DCF of 13.84% is unacceptable because it implies that the dividend growth rate is twice the nominal growth rate of the economy. Moreover, the *Virginia Arbitration Order* relied on the long-term average risk premiums as estimated by Ibbotson Associates.<sup>35</sup> According to Billingsley, the Ibbotson (now reported as Morningstar) estimate of the risk premium is 6.72%.<sup>36</sup> Using the Treasury Bond rate, a Beta of .89 and a risk premium of 6.72%, the CAPM estimate of the cost of equity is 8.7%. Given that the rate of return carriers are small companies, it would be acceptable to add a small company risk premium of 1.53%.<sup>37</sup> Therefore, the best estimate of the cost of equity, using the data provided by Dr. Billingsley and the *Virginia Arbitration Order* method, is 10.23%.

Next, Dr. Billingsley determines that the capital structure should be equal to a forward-looking capital structure, again based on the *Virginia Arbitration Order*.<sup>38</sup> That Order, however, addressed issues associated with estimating total element long-run incremental cost (“TELRIC”) prices, where TELRIC prices are based on forward-looking estimates. In this proceeding, the cost of capital will be applied to the High Cost Loop and Interstate Common Line Support mechanisms. Both of these methods rely on **embedded** cost data and therefore, it is

---

<sup>33</sup>/ The Ad Hoc Comments support a Beta of .88. See Ad Hoc, at 6, citing [http://pages.stern.nyu.edu/~adamodar/New\\_Home\\_Page/datafile/wacc.htm](http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/wacc.htm).

<sup>34</sup>/ Billingsley Affidavit, at 21.

<sup>35</sup>/ *Virginia Arbitration Order* at 83.

<sup>36</sup>/ Billingsley Affidavit, at 22.

<sup>37</sup>/ *Id.* at 25.

<sup>38</sup>/ *Id.* at 12-13.

inappropriate to use a forward-looking capital structure to estimate the cost of capital in this proceeding. Instead, the embedded capital structure should be used for this mechanism. The best estimate of the embedded capital structure is that the equity percent is 54.30% and the debt percent is 49.02%.<sup>39</sup>

The cost of debt should also be the embedded cost of debt. However, no party has reported an industry-wide embedded cost of debt in this proceeding. Instead, a forward looking cost of debt in the range of 3 to 5 percent has been used. Using the high end of the cost of debt range, the 10.23% cost of equity, and the Ad Hoc capital structure generates a reasonable cost of capital in the range of 7.84 percent. Based on this analysis, the Consumer Advocates recommend that the Commission reduce the current cost of capital and adopt a cost capital in the neighborhood of 7.8 Or 7.9 percent.

In addition to the Billingsley affidavit, the affidavit of Cherry and Wildman submitted by the Rural Associations argues that the Commission should adopt a cost of capital in the high end of the reasonable range of the cost of the capital estimates.<sup>40</sup> Their affidavits support the position that the cost of capital must be reasonable and allow the carriers to be financially viable.<sup>41</sup>

Consumer Advocates agree with the latter proposition regarding a reasonable cost of capital. However, there is nothing in that premise that requires that the cost of capital should be set at the high end of the reasonable range estimate. In addition there is nothing in the Rural Associations' plan that tracks the financial viability of the carriers and relates sufficient support to the financial viability of the carriers. On the other hand, the State Members plan submitted earlier in this proceeding does review the financial viability of carriers, and provides support that would help

---

<sup>39</sup>/ Ad Hoc, at 18.

<sup>40</sup>/ Affidavit of Cherry and Wildman, at 4.

<sup>41</sup>/ *Id.* at 2.

maintain the financial viability of those carriers. Therefore, the Cherry and Wildman affidavit confirms that the State Members' plan is superior to the Rural Association plan.

The process of establishing a rate of return, though informed by facts, ultimately represents a subjective assessment of relevant criteria. Consumer Advocates concur with Ad Hoc that the Commission "should be guided by facts and experience, not promises, speculation or threats."<sup>42</sup> Consumer Advocates support Ad Hoc's recommendation to rely on public data for determining the WACC.<sup>43</sup> Ad Hoc cites, specifically, the analysis of a professor at the New York University Stern School of Business, who publishes an annual WACC analysis based upon the Value Line database, which, for the most recent January 2011 analysis, yielded a WACC for the telecom sector of 6.24%.<sup>44</sup> Furthermore, as Ad Hoc observes, "[i]f evidence arises that individual carriers are unable to attract capital or undertake or maintain Broadband investment at the lower rates of return, they can petition for a 'Total Cost and Earnings Review.'"<sup>45</sup>

#### **B. The Budget Constraint, Sufficient Support and Revenue Benchmark**

The Rural Associations assert that their proposed plan meets the FCC's budget constraint through the application of a wholesale revenue benchmark. The budget constraint that the Rural Association's Plan ("RAP") allegedly meets is \$2.3 billion rather than the FCC's \$2.0 billion constraint.<sup>46</sup> Therefore, the RAP does not even meet the first criterion that it had been developed to meet.

Moreover, the Rural Associations have not placed into the record any evidence that the sum of these proposed CAF funding mechanism along with the remaining support mechanisms

---

<sup>42</sup>/ Ad Hoc, at 8.

<sup>43</sup>/ *Id.* at 2-6, Attachment A.

<sup>44</sup> *Id.* at 3-4.

<sup>45</sup> *Id.* at 10, citing Section XIII.G of the Order.

<sup>46</sup>/ Rural Association Comments, at 10.



(HCL and ICLS) and the new Recovery Mechanism will equal its \$2.3 billion target or the FCC budget constraint of \$2.0 billion. The RAP has, as an adjustment mechanism, the wholesale benchmark that could be used to ensure that sum of support equals a target support level. But that mechanism as proposed is set at a particular level that varies with broadband adoption rates. While the Rural Associations consider the adjustment mechanism to be a wholesale benchmark, the RAP does not provide any explanation of how it was determined or what wholesale costs or rates it is based on. That is, there is no evidence that relates the wholesale benchmark to the costs or rate for middle-mile or Internet transport services. Instead, it is clearly best described as a “fudge factor,” and we are required to accept on faith that it will force support to equal \$2.3 billion.

The Rural Associations describe this fudge factor as a wholesale benchmark in an effort to support the FCC’s continued insistence that broadband service be regulated under Title I of the Telecom Act.<sup>47</sup> The FCC, using tortured logic, declared that DSL service is telecommunications and not a telecommunications service, and condemned VoIP to a purgatory somewhere between the heaven of Title II and a resting place in Title I.<sup>48</sup> Because the clear purpose of the Order is to provide for ubiquitous and affordable broadband service and because a supported service must be a Title II service, the Consumer Advocates recommend that the FCC

---

<sup>47</sup>/ *Id.* at 19.

<sup>48</sup>/ *In the Matter of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, Report and Order, FCC 05-150, released September 23, 2005; *In the Matter of Preserving the Open Internet*, GN Docket No. 09-191, Report and Order, FCC 10-201, released December 23, 2010; *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501 (1998) (Stevens Report). *In the Matter of E911 Requirements for IP-Enabled Service Providers*, WC Docket No. 05-196, First Report and Order and Notice of Proposed Rulemaking, FCC 05-116, released June 3, 2005; *In the Matter of Universal Service Contribution Methodology*, WC Docket No. 06-122, Report and Order, FCC 06-94, released June 27, 2006; and *In the Matter of Universal Contribution Methodology*, WC Docket No. 06-122, Declaratory Ruling, FCC 10-185, released November 5, 2010.

reverse its earlier orders and adopt the position that DSL and VoIP are telecommunications services.<sup>49</sup>

Finally, the Consumer Advocates note that the State Members' Plan directly addresses the budget constraint and the sufficiency issue. Under that Plan, support can be reduced to meet the budget constraint by increasing the broadband and voice benchmarks. However, if the benchmarks are increased such that the implied rural rates are no longer comparable to urban rates, then there is a clear indication that the support is not sufficient.

### **C. Establishing constraints on annual expenses**

The Rural Associations oppose the imposition of regression constraints on their investments and expenses. They believe that these constraints are game changers and that the constraints will reduce investor confidence.<sup>50</sup> Consumer Advocates, on the other hand, believe that such constraints are part of any reasonable regulatory initiative. It has always been a part of the regulatory social contract that the regulator has the right to determine the difference between reasonable and non-reasonable expenses and investments. For too long, the FCC has accepted without question the reported expenses and investments of the rate-of-return carriers as filed with NECA and USAC. Because the number of carriers is large compared to the size of the FCC staff, it appears that the FCC's review of those filings has been very limited. Regression analysis provides the FCC staff with a low-cost tool to determine reasonable expenses and investment, and Consumer Advocates agree that regression analysis should be applied to determine whether rate-of-return carrier expenses and investments are reasonable. However, as Consumer Advocates pointed out in initial comments, regression analysis must be used properly and the

---

<sup>49/</sup> Such a reversal is not a unique event, so that the FCC cannot simply argue the difficulty of such changes. In fact, in the Order, the FCC is reversing its position that 251(B)(5) refers to only reciprocal compensation and is attempting to apply that section of the Act to all terminating minutes.

<sup>50/</sup> Rural Associations, at 11.

FCC's initial proposal did not meet the standards for proper use of regression analysis.

Therefore, Consumer Advocates continue to recommend that the FCC work with the industry and interested parties to develop a reasonable set of regression equations.

**D. Broadband Specific Service Measurements and Reporting Requirements**

The Rural Associations assert that the FCC should not require carriers to comply with specific service criteria and reporting requirements. Consumer Advocates disagree strongly with the Rural Associations on these issues. The FCC is providing carriers with support for the purpose of building and maintaining a ubiquitous and affordable broadband network. The support is being collected from end-users through a surcharge on bills. The FCC has the responsibility to ensure the end-users -- who are paying for the support -- that the support is being used for the designated purposes. The FCC cannot make those assurances unless it specifies the standards that the carriers must incorporate in their offerings.

Moreover, the FCC must collect information in a regular, systematic and public manner. This collection allows the FCC and the end-users to know how the universal service support payments are being used. To that end, the Consumer Advocates recommend that the FCC revise and enhance its ARMIS 43-07 Infrastructure Report and require all carriers to file the report. The enhancements should include, for example, the number of IP-capable switches and the number of premises served by fiber to the home facilities. The data for large carriers should be collected at the UNE zone level to enable the Commission and interested parties to make urban to rural comparisons. Collecting the information will allow the FCC to judge the success or failure of its programs. Making the information public will allow the public to understand the evolution of the public switched network<sup>51</sup> and to monitor how the carriers serve the areas.

---

<sup>51/</sup> The transformation from circuit switches to IP-capable switches does not mean that the public switched network is obsolete or is going away. It just means that the public switched network is based on a different technology.

## V. CONCLUSION

As discussed in initial comments, Consumer Advocates have grave doubts as to the legality and reasonableness of many aspect of the FCC's Order. Despite these doubts, Consumer Advocates have responded to selected issues raised in others' initial comments and may comment further in *ex parte* filings. Consumer Advocates urge the Commission to adopt these recommendations and adopt rules and policies that will lead to a net benefit for consumers.

Respectfully submitted,

Charles Acquard, Executive Director  
NASUCA  
8380 Colesville Road, Suite 101  
Silver Spring, MD 20910  
Phone (301) 589-6313  
Fax (301) 589-6380

William C. Black  
Deputy Public Advocate  
Wayne R. Jortner  
Senior Counsel  
Maine Office of Public Advocate  
SHS#112  
Augusta, ME 04333  
Phone (207) 287-2445  
Fax (207) 287-4317

Stefanie A. Brand  
Director  
Division of Rate Counsel  
Christopher J. White  
Deputy Rate Counsel  
P.O. Box 46005  
Newark, NJ 07101  
Phone (973) 648-2690  
Fax (973) 624-1047  
[www.rpa.state.nj.us](http://www.rpa.state.nj.us)  
[njratepayer@rpa.state.nj.us](mailto:njratepayer@rpa.state.nj.us)

Regina Costa  
Telecommunications Research Director  
TURN  
115 Sansome St., Suite 900  
San Francisco, CA 94104  
Ph. (415) 929-8876  
Fax (415) 929-1132  
[rcosta@turn.org](mailto:rcosta@turn.org)

February 15, 2012