



Proposed Interim Cap First Step in USF Overhaul

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High in Missouri's northeastern corner, in a pocket perhaps best known for guided deer and turkey hunts, managers of a local telephone cooperative are keeping an eye on federal Universal Service Fund (USF) reform efforts. The 55-year-old Mark Twain Rural Telephone Co. serves 4,500 subscribers across eight counties, and its costs are about four times higher than the national average. Mark Twain Rural Telephone Co. uses subsidies from the high-cost program to offset expenses and modernize its network. That's key to rural phone companies' views on USF cleanup: aid should stay in-state and wireless carriers should have to operate under the same regulations as incumbents.

The 11-year-old USF is ready for a makeover. The base of contributors continues to decline as more support goes out the door. In 2006, the high-cost program – the portion of the USF that subsidizes networks in rural, hard-to-reach and expensive markets – accounted for 61.8 percent, or \$4.1 billion, of USF disbursements, according to a report issued by the Congressional Research Service in April. What fueled the growth in the high-cost segment was something lawmakers in 1996 didn't anticipate: the mainstream adoption of wireless communications. A number of industry insiders say lawmakers assumed competitive carriers meant CLECs offering wireline alternatives rather than wireless operators. Accordingly, Congress, in crafting the USF during the telecom act rewrite, created the 'identical cost rule,' which gives competitors the same amount of subsidies LECs receive per line.

More than 760 miles northwest of Mark Twain Rural Telephone Co., there is another high-cost-fund success story courtesy of Alltel's wireless network. Before Alltel came into South Dakota's poverty-stricken Pine Ridge Reservation, fewer than 30 percent of the 30,000 members had phone service. Now, more than 80 percent of the tribe can get wireless phone service, thanks to the way Alltel used its money from the high-cost program, Alltel's head lawyer told the Senate earlier this year. This outcome backs up wireless carriers' views that USF reform is necessary, but not by capping receipts, a move that could curb network expansion.

And there's the rub. The \$7 billion USF needs an overhaul but no one quite agrees on how to go about it. So, for now, the FCC's Joint Board on Universal Service has singled out the high-cost program, blaming it for pushing the USF to near-unsustainable levels. In May, the joint board – made up of representatives from federal and state government,

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as well as various associations – recommended capping wireless carriers' high-cost USF proceeds at 2006 receipt levels for at least one year. That's because payments to competitive eligible telecommunications carriers (CETCs), which largely are wireless carriers, have increased from \$1 million in 2000 to \$1 billion in 2006, with the potential to go as high as \$2.5 billion by 2009, the Congressional Research Service found.

The proposal has not gone over well with the wireless industry or rural subscribers. It has, however, been a big hit with rural LECs, who resent the way wireless has cashed in on the USF. Here's why: The identical cost rule turned into a boon for competitive wireless carriers because they receive subsidies for every number they provision. Local phone companies, on the other hand, collect based on their network investments.

Rural LECs also don't like that competitors have fewer regulations when it comes to identical support. They don't have to invest in their networks before submitting costs for reimbursement – they receive support up front. The only hurdle is that competitive carriers must apply for CETC status from the states (and FCC) where they want to get USF money, and those requests aren't automatically granted.

To LECs, such as Mark Twain Rural Telephone Co., and ILEC associations, none of this is fair. "I'm not at all opposed to wireless carriers receiving support, but I think the support needs to be based on their costs, not ours," says Bill Rohde, general manager of the rural phone co-op.

Associations including The Organization for the Promotion and Advancement of Small Telecommunication Companies (OPASTCO) and the National Telecommunications Cooperative Association (NTCA) agree. To be sure, revamping the reimbursement process could be part of long-term USF change, but the joint board won't provide those suggested details until later this year. The cap is meant solely as a mechanism to slow the USF's uncontrolled inflation.

Implementing the cap also would shed light on wireless carriers' business practices, LEC representatives say. They allege many wireless companies certified as CETCs don't use as much of their USF distributions as they should to build in rural areas.

As proof, a group of rural telephone companies has asked the FCC to revoke Sprint's designation in Virginia "because they've proven that they [Sprint] haven't done any of the buildout they said they were going to do with their money," says Stuart Polkoff, OPASTCO's director of government relations.

If CETCs' USF money does remain in a given state, "Touché. But I don't think it is," says Shirley Bloomfield, vice president, government affairs and association services for NTCA.

Sprint would not respond except to provide a written statement opposing the interim cap. The company says it does not comment on open dockets and relies on its publicly

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filed comments at the FCC to speak for its position.

Polkoff adds that Sprint's alleged bad behavior is not indicative of all wireless CETCs. "I'm sure there are some good players," he says. "But by and large, this is what has been going on."

Two of the providers most active in the USF debate disagree. Alltel and U.S. Cellular – pure-play wireless carriers certified as CETCs – contend they do put high-cost funds toward rural buildouts in the appropriate states.

For example, in 2006, U.S. Cellular used all of the high-cost support it received in Maine to erect six cell sites in several small communities, the company says. Otherwise, says John Rooney, president and CEO, the towers would not have been constructed. By the end of 2007, U.S. Cellular will have added 11 more towers throughout the state thanks to the program, he says.

"U.S. Cellular uses USF high-cost support funds exclusively in areas where we are designated as an ETC," Rooney adds.

Alltel again points to its work on South Dakota's Pine Ridge Reservation as evidence it has used its high-cost proceeds appropriately. "Our service on that reservation has grown in lockstep with the designation that we received by the FCC for that reservation in the fall of 2002," says Mark Rubin, vice president of federal government affairs for Alltel.

LECs still dispute the claims and add that the USF money meant for rural regions often ends up in more profitable, populated markets instead. Wireless supporters shake their heads. "We do not use federal high-cost funds to construct facilities that serve urban areas," U.S. Cellular's Rooney says.

CTIA – The Wireless Association concurs. "We think that the subsidies equal increased service in rural areas and I think that the best way to settle this debate would be to talk to local officials, to talk to rural leaders and to listen to the outrage that has been voiced by leaders in rural areas about this proposal," says Joe Farren, director of public affairs for CTIA.

Indeed, the FCC docket on the interim cap has attracted more than 3,500 comments, with an overwhelming percentage coming from average citizens. [Click here](#) to read some of those submissions. Type 05-337 into the 'Proceedings' search box.

Leaders' and citizens' reactions to the proposed cap illustrates that states do hold wireless carriers accountable, Rubin says. First of all, landing CETC status is not a slam-dunk, he says. In fact, he points out, Florida in mid-June denied Alltel's petition to serve certain parts of the state as a CETC. Additionally, Missouri's public utilities commission for nearly two years has questioned and re-questioned U.S. Cellular's

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request to become a CETC in the state. This shows that applicants go through “rigorous and extensive” negotiations and, if a state grants a designation, “there is rigorous follow-up,” Rubin says.

“It isn’t the type of thing where we ... snooker them into granting a designation and then they never hear from us again,” he says.

Cap supporters, again, don’t see matters the same way. However, they say the states often are responsible for misuse of funds. They say states often designate CETCs willy-nilly, assuming more money will enter, and stay in, their markets. A cap would prompt states to think twice before certifying new CETCs, which would have to share the total dollars from 2006 (the numbers differ in every state).

The proposed cap comes as the FCC talks about revamping the entire USF system. The Joint Board has worked on changes to the high-cost fund since 2004, but FCC Chairman Kevin Martin has made it known he also wants renovation on the entire USF. It’s likely that long-term reform won’t get on the table until next year because, as one Medley Global Advisers analyst puts it, the issue is “politically sensitive and complex.”

But first steps first. The FCC is expected to decide in early November whether to implement the proposed cap. The final round of comments on the issue was due July 2.