

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

In the Matter of)	
)	
High-Cost Universal Service Support)	WC Docket No. 05-337
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45
)	

COMMENTS OF GENERAL COMMUNICATION, INC.

Tina Pidgeon
Vice-President –
Federal Regulatory Affairs
General Communication, Inc.
1130 17th Street, N.W., Suite 410
Washington, D.C. 20036
(202) 457-8812

John T. Nakahata
Brita D. Strandberg
Christopher Nierman
Harris, Wiltshire & Grannis LLP
1200 Eighteenth Street, N.W.
Washington, D.C. 20036
(202) 730-1300

Counsel for General Communication, Inc.

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Summary

The 1996 Act embraces both competition and universal service, seeking to reform telecommunications regulation to ensure that competition can take root while making sure that all consumers have access to quality services at affordable and reasonably comparable rates. GCI's experience, confirmed by economic theory, demonstrates that these two critical purposes work in tandem. GCI is in the process of deploying facilities-based universal and broadband services throughout Alaska, not just to the urban and regional centers, but also to hundreds of small villages with populations much smaller than the thresholds usually assumed suitable for competition. The only thing that could stop this facilities-based pro-competitive, pro-consumer, pro-universal service deployment is if the FCC adopts the CETC cap as proposed by the Joint Board.

The bottom line is that even in rural and remote areas, competition can bring consumers lower prices and increased choices, and competition drives both further cost reduction and service innovation in a way that no regulator can match in a single provider system. The Commission must keep these basic economic truths in mind as it undertakes long-overdue fundamental reform of the universal service high-cost support system. Rather than taking regulatory action that unnecessarily increases subsidies or favors incumbents over new entrants, the Commission should allow competition to rationalize rates, drive down prices, and serve the goals of universal service.

Certain fundamental principles must guide the Joint Board's and the Commission's efforts to reform the high-cost universal service program:

- ***Define outputs:*** The Joint Board and the Commission must once and for all define the outputs that they are seeking from high-cost universal service support mechanisms.

- ***Sever high-cost support from rate-of-return regulation:*** The Joint Board and the Commission must sever the link between high-cost support and rate-of-return regulation: a link that encourages inefficiency, artificially inflates costs, and implicitly subsidizes services not designated in Section 254(c). Rather, the fund should contribute only the minimum amount necessary to provide affordable service to high-cost areas.
- ***Allow multiple ETCs:*** The Joint Board and the Commission must not artificially limit the number of ETCs in any given high-cost area. Rather, multiple ETCs should be allowed to compete to provide the lowest cost, most efficient service. Indeed, harnessing competitive markets is the most straightforward way to ensure sufficient, but not excessive, support.
- ***Distinguish substitute from complementary service:*** The Joint Board and the Commission should carefully distinguish between those providers that predominantly offer their services as *substitutes* for the basic supported services and those that predominantly offer their services as *complements* to these services. In so doing, the Joint Board and Commission can – on a competitively and technologically neutral basis – rein in the increases in high cost support for complementary services, while preserving competitive and technological neutrality for substitute services.
- ***Implement symmetric, portable support:*** The Joint Board and the Commission must implement a true system of symmetric, portable support in which all carriers providing substitute services receive the same level of support on a per line basis for the customers they actually serve.
- ***End support for additional lines on residential accounts:*** The Joint Board and the Commission should no longer allow an ETC to receive multiple support payments for additional lines on residential accounts, which greatly exacerbates the growth of the high-cost fund without furthering universal service goals.

The Joint Board proposes several solutions that could go a long way towards fixing the high-cost support system, but only if they are implemented in a way that fosters competition.

- ***Reverse Auctions:*** Reverse auctions can provide a technologically and competitively neutral means of controlling fund growth and ensuring a move to most efficient technology, but not by allowing only a single ETC, which will wring competition out of marketplaces where it might have developed; create government-sanctioned, but still inefficient, monopolization; frustrate technology investment and innovation; and ultimately prevent the natural decrease in high-cost support that competition will engender.

- ***GIS Technology and Network Cost Modeling:*** In lieu of, or in combination with, reverse auctions, the Commission could use GIS technology and modern network cost modeling to determine the minimum support necessary to achieve affordable service and to target more precisely those customers that truly need high-cost support. Such modeling only works, however, if the Commission subjects every carrier providing substitute services to the same model, regardless of technology.
- ***Disaggregation of Support:*** The principle of disaggregation should guide the determination of the minimum support necessary to provide affordable service to any particular market, because it provides appropriate economic incentives to build facilities to serve both the higher and lower cost portions of the service area. To the extent, however, that any new disaggregation proponents are seeking additional funds as a result of disaggregation, they should be required to estimate what overall impact such disaggregation would have on the high-cost fund.
- ***Competitive ETC Support:*** For carriers that predominantly provide substitute services that compete head-to-head with the ILEC, symmetric, portable support is essential, whereas asymmetric support policies, such as a CETC “own costs” proposal, would entail greater total support, dull carriers’ incentives to reduce operating costs, and grant ILECs an unfair competitive advantage. Instead, the Joint Board and the Commission should move *all* carriers to a neutral basis of support – the minimum support necessary to provide affordable service to high-cost areas on a fixed per line basis – which will promote efficient competitors to use the support to provide service to areas where it may not otherwise be economically viable to do so and will provide ETCs with incentives to maximize profits by improving efficiency and thus lower their own costs.
- ***Broadband:*** To facilitate broadband deployment in high-cost areas, GCI proposes that the Commission should require, as a condition of eligibility, every ETC to be able to transmit through their last mile networks broadband at a mandatory minimum speed of 1 Mbps to a substantial majority of households within three years in the areas for which they are receiving support.

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COMMENTS OF GENERAL COMMUNICATION, INC.

In promulgating the Telecommunications Act of 1996 (the “1996 Act”), Congress aimed both to introduce competition in the telecommunications marketplace and to preserve universal service.¹ As the Senate Commerce Committee explained almost a dozen years ago, competition is critical to achieving successful, sustainable universal service at the lowest overall cost to society:

Competition and new technologies will greatly reduce the actual cost of providing universal service over time, thus reducing or eliminating the need for universal service support mechanisms as actual costs drop to a level that is at or below the affordable rate for such service in an area.²

Since then, the courts have similarly explained that in the wake of the 1996 Act, “[t]he FCC must see to it that *both* universal service and local competition are realized; one cannot be sacrificed in favor of the other.”³ And indeed, just weeks ago, Chairman

¹ *Qwest Communications Int’l Inc. v. FCC*, 398 F.3d 1222, 1226 (10th Cir. 2000) (“*Qwest II*”).

² Telecommunications Competition, S. Rep. No. 104-23 at 26 (1995).

³ *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 615 (5th Cir. 2000).

Martin likewise acknowledged that “[c]ompetitive forces spur innovation and push prices down,” and further noted, “When a regulatory issue comes before me, my first instinct is to pick the action that will help facilitate and promote competition, innovation, and consumer choice.”⁴ More than a decade after the 1996 Act, it is well past time to act on these goals and instincts and to use marketplace competition as the foundation for successful universal service policy.

Indeed, General Communication, Inc.’s (“GCI’s”) experience provides a shining example of the power of competition to reach even the most remote areas of the nation. GCI distinguishes itself from its competitors by offering its customers lower prices, more choices, and better service. It makes this facilities-based competitive effort not only in Alaska’s urban centers (which are small by national standards), but also increasingly (unless the Commission adopts the Joint Board’s CETC USF cap as proposed⁵) in outlying communities, many of which have populations of a few hundred – far below the threshold often assumed necessary for competition. As GCI has described in previous comments before the Joint Board and the Commission, GCI’s entry into markets

⁴ Remarks of FCC Chairman Kevin J. Martin, National Cable & Telecommunications Association, at 2 (May 7, 2007) (as prepared for delivery), *available at* http://www.fcc.gov/Daily_Releases/Daily_Business/2007/db0508/DOC-272897A1.pdf (“Fundamentally, your entry into the phone market benefits consumers, and I will support regulatory action to promote that entry and the competition it enables.”).

⁵ GCI will file separate comments responding to the Joint Board’s proposed CETC USF cap. *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 07-88 (rel. May 14, 2007) (“*CETC Cap NPRM*”); *Federal-State Joint Board on Universal Service*, Recommended Decision, WC Docket No. 05-337, CC Docket No. 96-45, FCC 07J-1 (Fed.-State Jt. Bd., rel. May 1, 2007) (“*Recommended Decision*”).

throughout Alaska has forced its competitors to improve their own offerings, thus benefiting consumers throughout Alaska.⁶

GCI is now in the midst of a rollout of a statewide local service platform that will be capable of delivering fixed and mobile wireless services and advanced Internet service.⁷ When fully deployed, GCI will provide local, long distance, and high speed broadband of at least 1 Mbps to the majority of households not just to Alaska's urban and regional centers, but also to hundreds of tiny villages. In the urban areas (Anchorage, Fairbanks, Juneau, and their suburbs, such as the Matanuska Valley) and in many of the regional centers, GCI is upgrading its cable plant and will provide telephone service predominantly over its own cable facilities, supplemented by resold services when necessary. In the rural villages, GCI will employ primarily wireless technology as its last-mile distribution network.⁸ In all areas, GCI will offer services that fully substitute for – not merely complement – those available from the ILEC. In some instances,

⁶ See *Federal-State Joint Board on Universal Service; The Merits of Using Auctions to Determine High-Cost Universal Service Support*, WC Docket 05-337, Comments of General Communication Inc. (October 10, 2006) (“*GCI Reverse Auction Comments*”); *Federal-State Joint Board on Universal Service; High-Cost Universal Service Support*, CC Docket 96-45, WC Docket 05-337, Comments of General Communication Inc. (March 27, 2006) (“*GCI Qwest II Remand Comments*”); See *Federal-State Joint Board on Universal Service; High-Cost Universal Service Support*, CC Docket 96-45, WC Docket 05-337, Reply Comments of General Communication Inc. (May 26, 2006) (“*GCI Qwest II Remand Reply Comments*”); *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service*; WC Docket No. 05-195; CC Docket 96-45, Comments of General Communication Inc. (October 18, 2005) (“*GCI USF Management Comments*”).

⁷ GCI has been certificated to provide local service in the vast majority of Alaska, with the requirement that it provide service not just in the regional centers, but also in all the villages within a given ILEC study area.

⁸ GCI will also offer wireline local service, via resale, for rural customers that request such service. GCI cannot, however, provide advanced broadband capability or the benefits of a diverse facilities-based network via resale.

moreover, GCI will go even further, providing true broadband (not merely 200 kbps broadband) where the ILEC offers no such service. The maps below show the stark contrast (based on data compiled by the Regulatory Commission of Alaska) between the limited geographic availability of broadband service greater than 1 Mbps in Alaska today (Figure 1) and the extensive availability of such services after GCI completes its statewide local rollout (Figure 2).

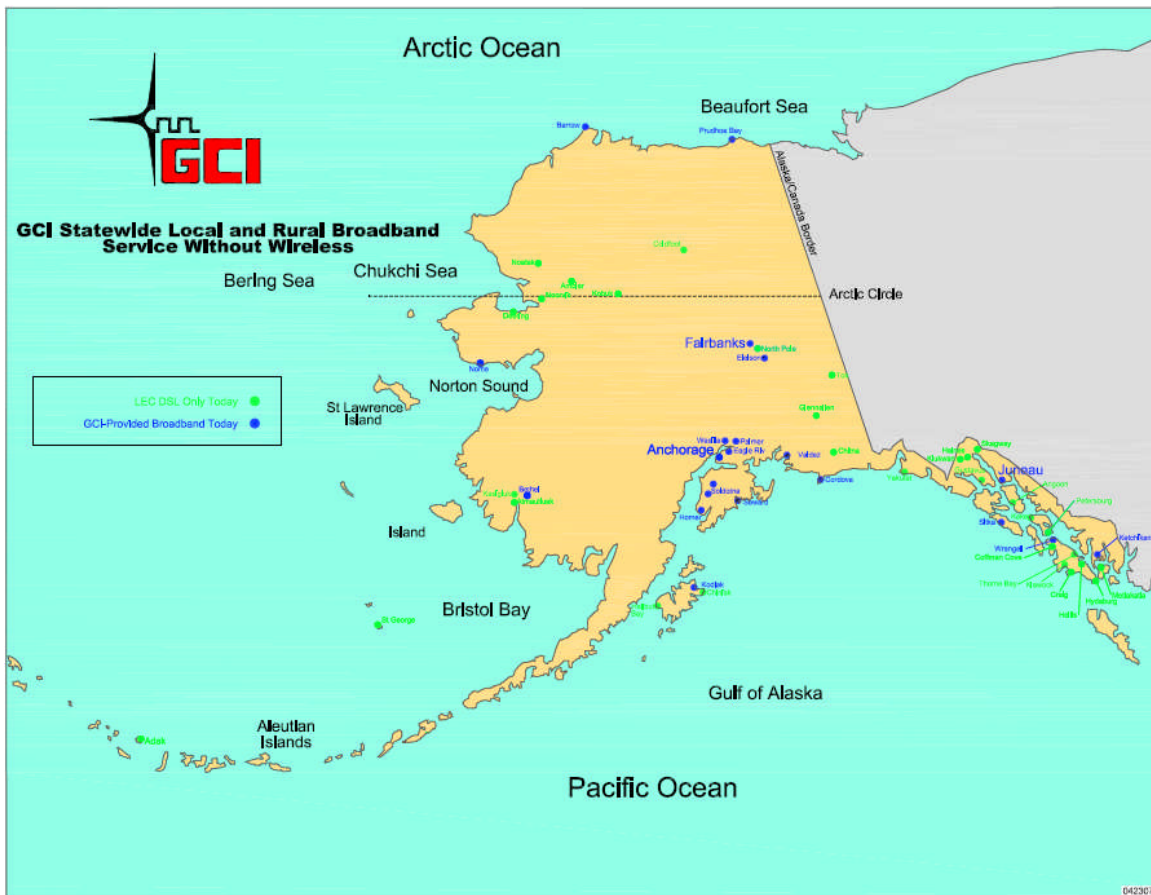


Figure 1: Local and Rural 1 Mbps Broadband Today

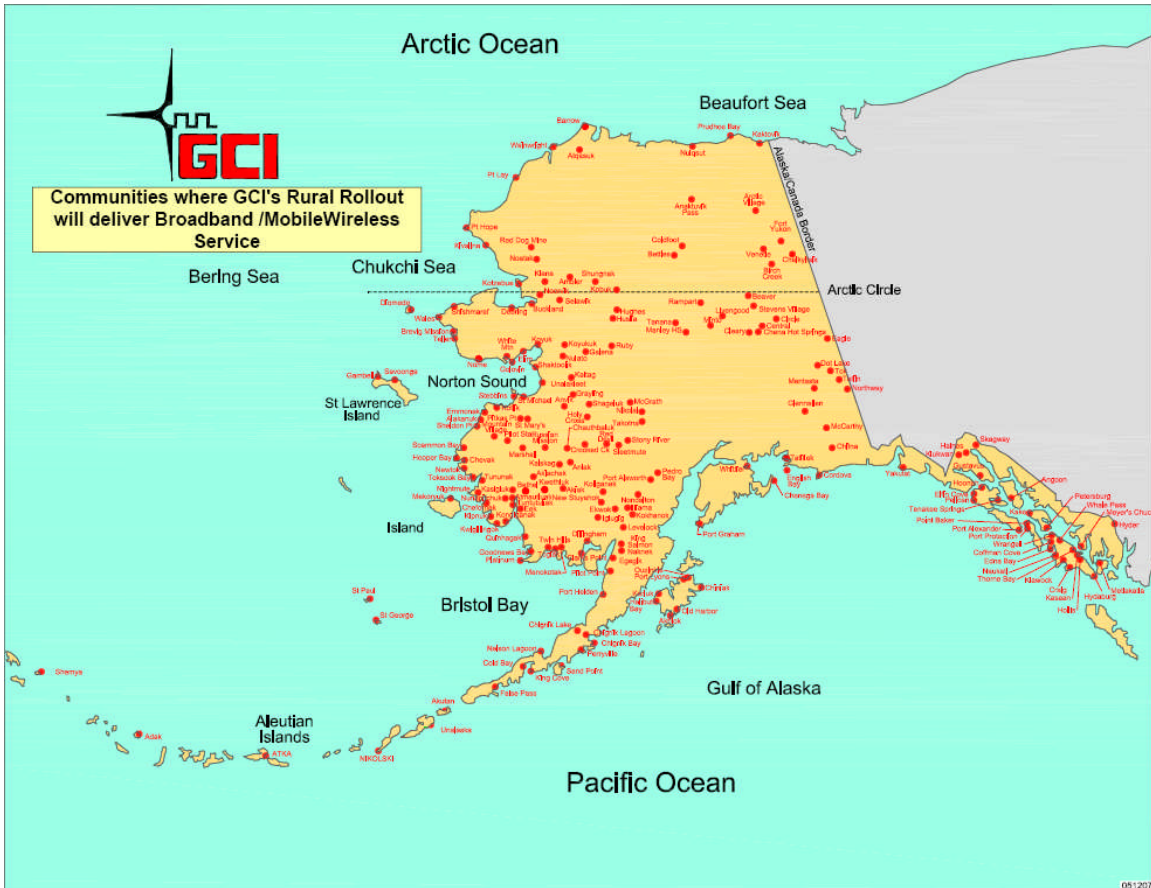


Figure 2: Local and Rural 1 Mbps Broadband After GCI Rollout⁹

GCI’s statewide local deployment plan demonstrates what competition can achieve in rural areas. But rural last-mile broadband which in areas it depends upon universal service support. GCI cannot afford to make the upfront capital outlay to build networks in these areas without sufficient universal service support. Even under the

⁹ GCI’s broadband cable modem service offers multimegabit broadband service to approximately 80 percent of Alaskan homes. In more remote areas, GCI offers high-speed Internet service using broadband platforms integrating cable, satellite, and wireless technologies. GCI now offers high-speed wireless Internet services of approximately 200 kbps at affordable prices to 121 villages, and serves 18 more villages by partnering with other providers and using wireless or DSL. These 200 kbps wireless systems, however, are in need of upgrades, both to provide higher speeds and to achieve full CALEA functionalities for traffic traveling solely within a particular WISP or DSL node. In both Figures 1 and 2, where GCI provides cable modem service, the ILEC also typically provides DSL service.

current system, GCI must build these competing advanced wireless networks with much lower total support than the ILEC receives today. As a CETC, GCI will receive support for only the customers it serves, whereas the ILEC receives support for its entire network. ILEC “total network” support continues even for portions of the network that run to customers that the ILEC no longer serves.¹⁰ Moreover, if CETCs are subject to discriminatory and arbitrary support caps, like that proposed by the Joint Board,¹¹ GCI’s plans for rural wireless advanced broadband statewide service will come to a halt.

Notably, GCI’s rural entry plans do not rely on support for multiple lines per household, which can occur today particularly (but not exclusively) with wireless CETCs. Whether support is disbursed on a primary line basis, as the Joint Board recommended three years ago,¹² or on a single line per residential account basis, as Qwest proposed more recently,¹³ GCI believes support would be sufficient to permit providers –

¹⁰ Moreover, while GCI’s advanced wireless plan is predicated upon its receiving the same support per line as the ILEC, it is not dependent upon GCI receiving increased support as the ILEC loses lines. GCI has always advocated, as the Rural Task Force initially recommended, see *In the Matter of Federal-State Joint Board on Universal Service*, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, CC Docket 96-45, at 37 (rel. September 29, 2000), that per line support be frozen for both the ILEC and the CETC upon CETC entry.

¹¹ *CETC Cap NPRM* ¶ 4; *Recommended Decision* ¶¶ 9–12.

¹² *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 19 FCC Rcd 10812 (¶¶ 62–87) (rel. February 27, 2004) (“*Primary Connection Recommended Decision*”).

¹³ *In the Matter of Federal-State Joint Board on Universal Service, High Cost Universal Service Support*, WC Docket 05-337; *In the Matter of Federal-State Joint Board on Universal Service CC Docket 96-45*, Comments of Qwest Communications, at 2 (April 26, 2007) (“Qwest’s proposed cap on high-cost support provided to ETCs would immediately cease further growth of the fund due to growth in per-line support. For the past several years, there has been increasing pressure for the costs per line for rural incumbent local exchange carriers to increase as their total lines decrease. Yet, this means that not only does the high-cost support per line for rural incumbent local exchange carriers (“ILECS”) increase, but so does the support to the

both ILEC ETCs and CETCs – to deploy advanced rural networks. To deploy such networks throughout Alaska, GCI – as a provider of services that fundamentally substitute for, rather than complement, the ILEC’s services – needs fair and rational – i.e., competitively and technologically neutral – access to the same support that the ILEC generally enjoys, on a per customer basis.

GCI’s planned entry into rural Alaska will bolster competition for universal service support throughout the state. Such competitive access to universal service support is superior to a single universal service provider because the competitive process forces all providers to improve their offerings. In GCI’s experience, even the impending threat of GCI’s market entry has produced positive competitive effects in more remote areas of Alaska where GCI has been authorized to provide service.¹⁴ In Nome, for example, where GCI acquired existing cable plant and began offering high-speed Internet access through cable modems, the Mukluk Telephone Company began offering its own high-speed Internet service. The Matanuska Telephone Association and the Ketchikan Public Utility have likewise responded to GCI’s anticipated market entry in their service areas by upgrading their traditional telecommunications networks to provide video services.

competitive ETCs (or “CETCs”) serving in the rural ILEC’s territory. A reasonable cap on per-line support will eliminate this irrational source of high-cost fund growth.”).

¹⁴ GCI’s local service certificate was amended to include Nome on February 6, 2006. *In the Matter of the Application by GCI COMMUNICATION CORP. d/b/a GENERAL COMMUNICATION, INC. and GCI for an Amendment to its Certificate of Public Convenience and Necessity to Operate as a Competitive Local Exchange Telecommunications Carrier, Order Approving Remaining Portions of Application Subject to Conditions, Addressing Service Area Issues, and Requiring Filings, RCA Docket No. U-05-046 Order 6 (Feb. 2, 2006).*

High-cost support reform must be modeled on competitive principles to preserve the opportunity for similar competitive success stories in the nation's rural areas. Particularly for services that predominantly substitute for (rather than merely complement) the ILEC's services, support must be competitively neutral, *i.e.*, the ILEC and the CETC must receive the same level of support – which need not be based on the ILEC's rate-of-return regulated “cost-of-service.” The Joint Board and the Commission should also define more clearly the specific dimensions of universal service that must be provided – in terms of the maximum affordable price, quality, and any minimum broadband capability. The Joint Board and the Commission need not – and indeed should not – support multiple lines per home or account, which only contributes to the unsustainable expansion of the high-cost support fund.

I. Fundamental Principles of Long Term, Comprehensive High-Cost Universal Service Reform

Whatever regulatory details ultimately emerge, certain fundamental principles must guide the Joint Board's and the Commission's efforts to reform the high-cost universal service program.

A. Define Outputs

The Joint Board and the Commission must once and for all define the outputs that they are seeking from high-cost universal service support mechanisms. Specifically, the Joint Board and the Commission must define not only the level of service (such as voice grade access to the public switched telephone network), but also the maximum prices that are affordable and reasonably comparable to urban areas. Without these basic output measures, there can be no true long term reform, because neither the Joint Board

nor the Commission – nor the public – will ever know whether universal service support is sufficient, insufficient, or excessive. This step is necessary regardless of whether the Joint Board and the Commission ultimately opt to employ reverse auctions, network cost models, or some other system of determining support.

Furthermore, the Joint Board and the Commission must explicitly identify in objective, measurable terms any additional factors to be considerations in setting levels of ETC support or selecting ETC providers. For example, the Joint Board and the Commission should specify any minimum quality of service requirements or commitments to providing minimum data transmission speeds such as broadband speeds of at least 1 Mbps to a majority of households within three years.

B. Sever High-cost Support From Rate-of-return Regulation

The Joint Board and the Commission must seek to deliver the specified universal service outputs in the most efficient manner. This means severing the link between high-cost support and rate-of-return regulation; a link that encourages inefficiency, artificially inflates costs, and implicitly subsidizes services not designated in Section 254(c). Rather, the fund should contribute only the minimum amount necessary to provide affordable service to high-cost areas. This step is long overdue.

In some areas, where there is only one ETC providing the defined universal service, that may mean starting with the support received today, capping it on a per line basis, and adjusting it so that support is neither more nor less than necessary to provide affordable and reasonably comparable universal service at the maximum permissible rates. In other areas, reverse auctions, cost models, or even the market itself may be used to determine the amount of support necessary to provide to competing providers

(including the incumbent) on a per line basis at the maximum permissible prices (or below those prices if that can be done without any subsidy at all).

Indeed, the Commission's principle of competitive neutrality, adopted pursuant to Section 254(b)(7),¹⁵ requires limiting support to only what is necessary to achieve the goals of Section 254(b). Because high-cost support is available only to eligible telecommunications carriers, support necessarily distorts competition whenever a supported service provider competes with a non-supported service provider. For example, an ETC will receive high-cost support for service to a particular multiline business customer, while a non-ETC LEC serving the same customer will not. While such distortions may to some extent be unavoidable,¹⁶ excessive support unnecessarily exacerbates competitive bias and increases costs. As a corollary, the Commission should cease support altogether where the market efficiently serves customers. In other words, where a carrier is willing to provide service to a formerly high-cost area without any USF payments, no support is necessary to provide service and those payments should cease.

C. Allow Multiple ETCs

The Joint Board and the Commission must not artificially limit the number of ETCs in any given high-cost area. Rather, multiple ETCs should be allowed to compete to provide the lowest cost, most efficient service. Indeed, harnessing competitive markets is the most straightforward way to ensure sufficient, but not excessive, support.

As former FCC Chief Economist Dr. David Sappington has explained:

¹⁵ 47 U.S.C. § 254(b)(7); *Federal-State Joint Board on Universal Service, Report and Order*, 12 FCC Rcd 8776, 8801-03 (¶¶ 46-52) (1997) (“*First Universal Service Report and Order*”); *see also* Chairman Martin’s NCTA Remarks at 2, 5.

¹⁶ These distortions can be minimized through support disaggregation, when the ILEC elects to disaggregate.

[T]he competitive approach allows the market continually to identify the most efficient suppliers of supported telecommunications services, to provide appropriate incentives to those suppliers and their competitors alike, to deliver universal services at minimum cost, and to continually reduce the costs and improve the quality of telecommunications services.¹⁷

Chairman Martin has similarly expressed his belief “in leveling the regulatory playing field for the purpose of fostering a competitive marketplace.”¹⁸ The Joint Board and the Commission should effectuate that belief and base reforms on the economic truism that “the competitive process, not regulatory pre-selection of a single universal service provider, is the best means to ensure the delivery of supported telecommunications services at minimum cost to consumers.”¹⁹

D. Distinguish Substitute From Complementary Service

The Joint Board and the Commission should carefully distinguish between those providers that predominantly offer their services as *substitutes* for the ILEC’s services and those that predominantly offer their services as *complements* to the ILEC’s. One of the fundamental problems with today’s high-cost support system is the assumption that all competing ETCs are providing substitute services. As a result, it provides support under the identical support rule, even when some ETCs are predominantly offering services that merely complement the ILEC’s, *i.e.*, services that an ILEC subscriber would subscribe to in addition to their supported ILEC service. While there may be value in

¹⁷ David E.M. Sappington, *Harnessing Competitive Forces To Foster Economical Universal Service*, at 18, filed in CC Docket No. 96-45 attached to the letter of Tina M. Pidgeon, Vice President, Federal Regulatory Affairs, GCI, to Marlene H. Dortch, Secretary, FCC (Dec. 19, 2003) (“*Sappington*”), attached hereto as Exhibit 1.

¹⁸ Chairman Martin’s NCTA Remarks at 5.

¹⁹ *Sappington* at 1 (“Among the many benefits of competition is its ability to constantly motivate industry suppliers to reduce their operating costs over time, and thereby limit the total support required to ensure the delivery of high quality services at affordable rates.”).

supporting complementary services (such as ensuring that rural consumers also have the benefits of mobility), complementary services, by definition, do not operate within the same product market. Thus, a support mechanism that treats substitute products the same, but complementary products differently does not threaten competitive neutrality. Although the line between services that are substitutes and complements is not clean – and will blur even further as the telecommunications industry develops – it is possible to distinguish between services that are predominantly substitutes for, and those that are predominantly complements to, the basic supported services. Such a distinction is both competitively and technologically neutral, consistent with the Joint Board’s and the Commission’s principles for universal service.

The difference between substitute and complementary ETC services is evident from the number of ILEC-affiliated wireless CETCs that are certified as ETCs in their own ILEC wireline service area (for which they are also receiving support). In at least nine wireline ILEC study areas in Alaska, the ILEC also operates a wireless CETC. This phenomena – ILEC-affiliated CETCs operating in the ILEC wireless service area – commonly occurs throughout the country. These ILEC-affiliated CETCs clearly operate to offer services that fundamentally complement, rather than compete with, the ILEC operations.

It is notable that today, wireline CETCs, which are likely offering predominantly substitute services, account for only a small part of the high cost fund distributions. According to the most recent USAC statistics, in 2006, these providers of substitute services received only \$15 million in support, with first quarter 2007 distributions on an

annualized pace even below that level.²⁰ By contrast, the wireless CETCs, which predominantly offer services that complement the basic supported services, received \$965 million in 2006, and based on the first quarter 2007 distributions are on a pace to exceed \$1 billion in 2007.²¹ By distinguishing between substitute and complementary services, the Joint Board and Commission can – on a competitively and technologically neutral basis – rein in the increases in high cost support for complementary services, while preserving competitive and technological neutrality for substitute services.

E. Implement Symmetric, Portable Support

The Joint Board and the Commission must implement a true system of symmetric, portable support in which all carriers providing substitute services receive the same level of support on a per line basis for the customers they actually serve. There is simply no economic rationale to continue distributing ILEC support on a lump sum basis irrespective of lines served, paying providers for lines to customers to which they provide no service. Any concerns of “cherry-picking” or “cream-skimming” should be addressed through disaggregation plans. Moreover, providers of substitute services should receive the same amount of support per supported customer line. The ILEC should not receive more support if it wins a customer than does GCI, and vice versa. Otherwise, the universal service system will encourage inefficiency and blunt market incentives to provide the best services most efficiently.

²⁰ See http://www.usac.org/_res/documents/about/pdf/fund-facts/HC%20Wireline-Wireless%20Distribution%20042307.pdf. Based on the first quarter 2007 distributions, annualized, wireline CETCs are on a pace to receive less than \$12 million in 2007 – dropping below 2006 levels without the application of any caps.

²¹ See *id.*

F. End Support for Additional Lines on Residential Accounts

The Joint Board and the Commission should no longer allow an ETC to receive multiple support payments for additional lines on residential accounts. An ETC that receives support to provide a traditional residential phone line, should not also receive support to provide a second phone line or a fax line to that home. Moreover, a wireless ETC should not receive windfall support payments for additional lines for a family plan to a single household, when the costs of service do not expand linearly.²² These abuses of the high-cost support program, which arguably exceed the bounds of what are reasonably part of the “supported services,” exacerbate the growth of the high-cost fund without furthering universal service goals. Primary line-based support, as the Joint Board proposed in 2004,²³ would be the most competitively neutral approach. Alternatively a single supported line per ETC account approach, as has been proposed more recently, would still substantially reform high-cost support and check an unnecessary source of growth.

II. Any Implementation of the Joint Board’s Proposed Reforms Must Incorporate the Above Principles

Structuring the high-cost support mechanism to allow competition among providers serves the goal and delivers the benefits of competitive neutrality without sacrificing other universal service principles. Competition, in other words, minimizes support and allows the market as a whole to set rates that are just and reasonable. There are a number of ways to reform the high-cost universal service program and control fund

²² Indeed, Chairman Martin has expressly stated, “I believe we need to limit the ability of rural consumers to receive support for multiple phones.” Responses to Chairman Markey’s April 2, 2007 Letter at 3.

²³ *Primary Connection Recommended Decision* at ¶¶ 62–87.

growth by preserving free market principles to the greatest extent possible. The Joint Board proposes several solutions that could go a long way towards fixing the problem, but only if they are implemented in a way that fosters competition.

A. Reverse Auctions

As Chairman Martin and others have recognized, “reverse auctions could provide a technologically and competitively neutral means of controlling fund growth and ensuring a move to most efficient technology over time.”²⁴ GCI agrees, but cautions the Joint Board and the Commission not to treat a reverse auction as a replacement for the competitive marketplace or a one-size-fits-all solution that will, in any of its myriad potential forms, heal the ills of the current high-cost support program.²⁵ Although the auction process is by nature competitive, an auction that produces a single “winner” is not a suitable substitute for real marketplace competition, particularly in a fast-changing, technologically-driven marketplace. Moreover, if auction terms are fairly long, a single winner auction will install a monopoly provider, with no incentive to respond to technological changes and potential competition during the license term.

To illustrate: GCI is now moving to enter markets using wireless technologies that were not available a few years ago. A single-winner auction would lock GCI out of the market for the term of the auctioned license – even where technological changes would have otherwise allowed competition during the interim. Accordingly, as GCI has explained previously in this proceeding,²⁶ the Commission should use an auction not to

²⁴ *Federal-State Joint Board on Universal Service Seeks Comment on Long Term, Comprehensive High-Cost Universal Service Reform*, WC Docket No. 05-337, CC Docket No. 96-45, Public Notice, (¶ 4) (May 1, 2007) (“Public Notice”).

²⁵ See GCI Reverse Auction Comments.

²⁶ See generally GCI Reverse Auction Comments.

decide *which provider* will serve any particular high-cost area, but instead to determine the *amount of subsidy* necessary for an efficient and capable provider to serve the defined market and then allow any ETC to receive per line support for that market. As Dennis Weller has explained, “[i]f we wish to design a universal service program that is compatible with competition, it hardly seems reasonable to begin with a model that assumes a single universal service provider.”²⁷ Instead, allowing multiple bidders to win an auction can harness the benefits of “competition for the market” – in which carriers compete for the right to serve as one of a limited number of supported carriers – without foreclosing “competition in the market” – in which several carriers accept universal service obligations and compete to acquire subscribers and the associated support payments.²⁸ Under Weller’s proposal, bidders within a certain range are accepted and allowed to compete for universal support for a given area, while bidders outside a certain range are excluded for three years to provide incentive to bid “for the market.”²⁹

In the first instance, use of a reverse auction would not obviate the need to specifically define the outputs sought to be achieved through the high-cost mechanism. Indeed, a reverse auction would make it all the more important to define these outputs. Under any auction mechanism, carriers must know what they are bidding for. The Commission must expressly define the supported service and applicable regulatory requirements *before* any auction. This will allow the Commission to ensure that, where the market has demonstrated that a subsidy is unnecessary, none will be provided.

²⁷ D. Weller, *Auctions for Universal Service Obligations*, 23 Telecommunications Policy 645, 654 (1999) (“Weller”).

²⁸ *Id.*

²⁹ *Id.* at 667-68.

Second, a reverse auction that allows only a single ETC – or even that limits the winners to one wireless and one wireline ETC³⁰ – will wring competition out of markets where it might have developed; create government-sanctioned, but still inefficient, monopolization; frustrate technology investment and innovation; and ultimately prevent the natural decrease in high-cost support that competition will engender. As Chairman Martin has acknowledged, “[i]f the Commission implemented a reverse auction and limited the number of lines, but *allowed multiple providers to receive support, it could serve to stem growth [of the fund].*”³¹ This is especially true because technology is rapidly changing. As mentioned above, GCI’s next generation rural networks use existing spectrum, but with newer technologies. The 700 MHz auction and the TV white spaces proposals, for instance, could dramatically change the amount of spectrum available in rural areas for competitive telecommunications services. Locking in single providers ignores the significant potential for advances in delivering cost-effective universal services to rural areas. This is no less true if the auction allows one wireless ETC and one wireline ETC auction winner, as Verizon has proposed. Because wireless and wireline ETCs provide predominantly complementary, rather than substitute, service, that proposal will not provide real competition and thus flies in the face of basic economics.

That a single provider will most efficiently provide universal service in hard-to-serve rural areas is contrary to both the rationale of the 1996 Telecommunication Act and the worldwide economic experience during the twentieth century. The 1996 Act

³⁰ See Letter from Kathleen Grillo, Vice President Federal Regulatory, Verizon, to Deborah Taylor Tate, Federal Chair and Ray Baum, State Chair, Federal-State Joint Board on Universal Service, WC Docket No. 05-337, at 7-8 (dated Feb. 9, 2007).

³¹ Responses to Chairman Markey’s April 2, 2007 Letter at 3.

expressly rejected the notion that telecommunications would be best provided by local monopolies, regulated to serve the public interest, and instead embraced competitive markets. The world as a whole during the twentieth century saw the same thing: in no setting has the selection of a single provider by the government (such as in the Soviet Union and Cold War Eastern Europe) proven to be a more effective means of economic organization than a competitive market. While there may be some areas of the market that will support only one ETC (or just one wireless and one wireline ETC), the market itself will best make that determination, rather than having regulators determining market structure *ab initio* – under the guise of a reverse auction. Any reverse auction should be structured to let “the ‘invisible hand’ of self-correcting market mechanisms, not regulatory fiat, determine[] the number and the identity of firms that thrive in the marketplace.”³²

In addition, no auction can succeed so long as existing RLEC regulatory protections are maintained. At minimum, RLEC auction participants must be required to interconnect, exchange traffic, and port telephone numbers with other ETCs. Likewise, no auction can be efficient and fair unless the incumbent – like any other bidder – could lose support. Incumbents should receive no special protections or advantages based on their status as the incumbent provider. Otherwise auctions will fail in their central purpose – revealing the cost-efficient level of support.

Finally, it must be recognized that, for rate-of-return ILECs, a reverse auction would fundamentally divorce universal service support from the historical revenue requirement of incumbent carriers. This is a long-overdue step, and the Commission

³² Sappington at 19.

should build on it by adopting additional measures that would likewise limit growth of the high-cost fund.

B. GIS Technology and Network Cost Modeling

In lieu of, or in combination with, reverse auctions, the Commission could use GIS technology and modern network cost modeling to determine the minimum support necessary to achieve affordable service. Indeed, ten years ago, the Commission did “support an eventual shift from the existing system” of determining support, but declined to adopt cost modeling to determine rural high-cost support because “proposed models could not *at this time* precisely model small, rural carriers’ cost.”³³ But, as the second panel at the *en banc* hearing demonstrated,³⁴ modern GIS technology and modeling techniques can more effectively identify and target those customers that truly need high-cost support on more precise geographic bases, thereby weeding out those customers that do not truly need such support and reducing the amount of support required. Such modeling only works, however, if the Commission subjected every carrier providing substitute services to the same model.

Moreover, the Commission could use GIS technology and cost modeling as a means to determine a reserve price for a reverse auction, thus hedging against the possibility that a cost model overestimated the minimum price and allowing efficient ETCs to bid under that model. On the other hand, if the Commission finds that the

³³ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45,12 FCC Rcd 8776, 8934 (¶ 291) (rel. May 8, 1997) (emphasis added).

³⁴ See *Federal-State Joint Board on Universal Service to Hold En Banc Hearing on High-Cost Universal Service Support in Areas Served by Rural Carriers*, WC Docket No. 05-337, Public Notice, 22 FCC Rcd 2545 (2007). Statements, slides and audio transcripts are available at http://www.fcc.gov/wcb/tapd/universal_service/JointBoard/welcome.html.

modeling results underestimated the costs and failed to produce competition and affordable high-cost service, it could adjust the model upwards to produce such a result.

Not only are modern modeling techniques better than those of a decade ago, but they are far superior to an “own costs” method of determining high-cost support. As discussed further below, an “own costs” method, among other problems, blunts the competitive market’s inherent incentives to reduce costs in order to reduce prices and increase efficiency, applies the efficiency-deadening incentives of ratebase rate-of-return regulation to all ETCs, fails to recognize that all carriers are building multifunctional networks with high degrees of common costs, and likely cannot be meaningfully implemented and policed.³⁵

C. Disaggregation of Support

The Commission asks whether it “should require all carriers to disaggregate support below the study area, or wire center, level.”³⁶ GCI has long touted the benefits of disaggregating universal support.³⁷ When support is averaged, rather than disaggregated, any new ETC will have a disincentive to build facilities to serve the higher-cost portions of a study area, rather than reselling the ILEC’s service in those higher-cost areas.³⁸

When support is disaggregated, on the other hand, a new ETC receives geographically deaveraged support, which would be lower (potentially nothing) for serving the lower-

³⁵ See *supra* at II.D.

³⁶ Public Notice ¶ 6.

³⁷ See, e.g., Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage LEC Study Area, GCI Ex Parte Letter, WC Docket No. 05-281 (filed June 30, 2006).

³⁸ Under FCC rules, when a carrier resells the service of another carrier, the resale carrier does not receive universal service support, but such support goes instead to the reselling carrier.

cost portion of the study area, and higher if it served the higher-cost portions of the study area using its own facilities. Thus, disaggregating support provides appropriate economic incentives to build facilities to serve both the high-cost and low-cost portions of the service area.

The principle of disaggregation should guide the determination of the minimum support necessary to provide affordable service to any particular market. Thus, for example, if the Joint Board and the Commission decide to use a reverse auction to identify the support appropriate support amount, the auction markets should be defined so that truly high-cost areas are separate from areas that are less costly to serve, whether that is on a wire center or sub-wire center basis. Similarly, if network cost-modeling is used to determine the per line support amount, the models should be as granular as administratively possible to properly identify the truly minimum amount necessary to provide service to any one area.

GCI notes, however, that ILECs – particularly rural, rate-of-return ILECs – already have sufficient authority to disaggregate.³⁹ These carriers have the authority, subject only to State Commission approval, to change their existing disaggregation elections and plans.⁴⁰ The Joint Board could go further and mandate cost-based disaggregation by ILECs, which would in essence protect ILECs against their own bad choices and provide a further assurance that universal service support is being targeted to the higher-cost lines within a study area. To the extent, however, that an ETC is seeking additional funds as a result of disaggregation, it should be required to estimate what overall impact such disaggregation would have on the high-cost fund.

³⁹ See 47 C.F.R. § 54.315.

⁴⁰ See 47 C.F.R. § 54.315(b)(4), (c)(5), and (d)(5).

D. Competitive ETC Support

The Joint Board's proposal to "consider abandoning or modifying the so-called identical support or portability rule" fails to acknowledge that support amounts between ILECs and CETCs is already disparate. At minimum, per-line based support should be maintained, at least as to ETCs that predominantly provide services that substitute for the ILEC's.⁴¹ As Advocate Gregg has forcefully pointed out, when it was originally adopted, the identical support rule expressly contemplated that ETCs were offering *substitute* services.⁴² Under the rule as originally adopted, the CETC was to receive support for every line that it won, and the ILEC correspondingly was to have its support reduced for every line that it lost. The express purpose of this regime was to ensure that support flowed to the carrier actually providing universal service over its facilities.⁴³

For a service that predominantly complements the ILEC's service, the same rationale does not necessarily apply. Identical support is not necessary to preserve market incentives for complementary products that typically do not compete in the same market (or do so only to a limited extent). Complementary services are, by definition, bought by consumers at the same time as ILEC services. Thus, supporting a complementary service at a level necessary to achieve the universal service goals with

⁴¹ See Public Notice ¶ 7; Recommended Decision, FCC 07J-1 (¶ 12).

⁴² *Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules Relating to High-Cost Universal Service Support, Appendix B Three Stage Package for Universal Service Reform*", proposed by Joint Board Member Billy Jack Gregg, Director of the West Virginia Consumer Advocate Division, Public Notice Appendix B, p. 9-10. CC Docket No. 96-45, FCC 05J-1, Public Notice (rel. August 17, 2005).

⁴³ *First Universal Service Report and Order* ¶ 286.

respect to that complementary service should have little effect on incentives to provide services that substitute for ILEC services.

For carriers that predominantly provide substitute services that compete head-to-head with ILEC, however, symmetric, portable support is essential. Indeed, the Commission has recognized expressly that providing universal service support to one carrier, but not another, creates a substantial barrier to entry:

A new entrant faces a substantial barrier to entry if its main competitor is receiving substantial support from the state government that is not available to the new entrant. A mechanism that makes only ILECs eligible for explicit support would effectively lower the price of ILEC-provided service relative to competitor-provided service by an amount equivalent to the amount of support provided to the ILECs that was not available to their competitors.⁴⁴

The same is true when differential support is provided to two providers of substitute services – to prevail in the marketplace, the provider that receives less support must be more efficient than the other provider by more than the differential in support. This assumes, of course, that a new provider would have any incentive to enter at all under a regime of unequal revenue opportunities.

Competitively neutral universal service mechanisms – mechanisms that at least distribute the same per line support to all ETCs – are essential to competition, and to preserving the incentives for all providers to reduce costs and become more efficient. Paying all providers the same amount of support neutralizes the market-distorting effects of the relevant subsidy, allowing the universal service program to harness the economic

⁴⁴ *Western Wireless Corporation Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, Memorandum Opinion and Order, 15 FCC Rcd 16227, 16231 (¶8) (2000).

efficiencies of the competitive marketplace.⁴⁵ As Dr. David Sappington has explained, symmetric support policies help to avoid excessive support in two ways:

First, they help to ensure that consumers are served by the least-cost supplier, just as they are in competitive markets. When industry costs are minimized, the support required to ensure affordable and reasonably comparable prices also can be minimized. Second, symmetric support policies can provide strong incentives for industry suppliers to minimize their current operating costs and to continually strive to secure even lower operating costs in the future.⁴⁶

Asymmetric support policies, by contrast, entail greater total support, dull carriers' incentives to reduce operating costs, and grant ILECs an unfair competitive advantage.⁴⁷

To the extent that there is a "problem" with the identical support rule in the context of substitute, rather than complementary, service, the most frequently cited issue is the "upward spiral" of support levels that occurs when a rate-of-return carrier loses lines to any other carrier (whether or not an ETC). This problem, however, lies, *first*, in basing the support for any carrier on the ILECs costs under a rate-based, rate-of-return system. Such a system has long been recognized to produce inefficiency and wasteful

⁴⁵ Doing so likewise satisfies the Commission-adopted principle that universal service be competitively neutral. Conforming to this principle is particularly important when parties are competing with bundles of complementary products. Otherwise, one provider (*e.g.*, a DSL provider that receives embedded cost support for building DSL-capable loops) may receive a subsidy for which other providers of the same service are ineligible (*e.g.*, a cable operator providing high-speed data and video). This is inefficient, market distorting, and inconsistent with the Commission adopted principle of competitive neutrality. 47 U.S.C. § 254(b)(7); *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8801-03 (¶¶ 46-52) (1997) ("*First Universal Service Report and Order*") (adding principle of competitive neutrality), *aff'd in part and rev'd in part*, *Texas Office of Pub. Util. Counsel vs. FCC*, 183 F.3d 393 (5th Cir. 1999). Congress is currently considering legislation that would codify this principle. *See* Communications Opportunity, Promotion, and Enhancement Act of 2006, H.R. 5252, 109th Cong. § 253 (2006) (as reported in Senate).

⁴⁶ Sappington at 25.

⁴⁷ *Id.* at 27-30.

spending.⁴⁸ The Joint Board and the Commission should counter this problem not by limiting the number of ETCs⁴⁹ or relying on asymmetrical support based on CETCs' "own costs,"⁵⁰ which will stunt competition and encourage inefficient service provision, but rather by moving *all* carriers to a neutral basis of support – the minimum support necessary to provide affordable service to high-cost areas on a fixed per line basis. This will allow efficient competitors to use the support to provide service to areas where it may not otherwise be economically viable to do so. Moreover, because the support is static and not tied to costs, ETCs will have every incentive to maximize profits by improving efficiency and thus lower their own costs. The Commission and Joint Board can then evaluate the results and recapture (perhaps with a lag to preserve incentives to reduce costs) some of the benefits of greater efficiency to reduce the demand on the fund. Such a regime stands in stark contrast to the current system which perversely motivates rate-of-return ILEC ETCs to increase (or simply maintain) their own costs to increase their support payments.

A less dramatic change in ILEC ETC support would be, as the Rural Task Force recommended, simply to freeze per-line support for all ETCs upon CETC entry, and then

⁴⁸ *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-20 (1990) (LEC Price Cap Order); *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873 (¶¶29-35) (1989).

⁴⁹ Public Notice ¶ 7 ("In light of the uncontrolled growth in competitive ETC support in recent years, we also seek comment on how we should view the funding of multiple carriers in high-cost areas.").

⁵⁰ Public Notice ¶ 7 ("We seek comment on whether the Commission should replace the current identical support rule with a requirement that competitive ETCs demonstrate their own costs in order to receive support.").

to distribute high-cost support to all ETCs on a per-supported-line basis.⁵¹ In that case, all ETCs would receive support for the lines they serve, and would not receive support for lines they do not serve. The ILEC ETC's support per line would not increase if a CETC offering substitute services wins market share from the ILEC. At the same time, the system could rely on competition between the providers to ensure that rates remained affordable and reasonably comparable. Moreover, by freezing support per line upon CETC entry, the high-cost fund would not subsidize post-CETC-entry ILEC investments in complementary services (such as broadband and video) as part of a competitive response to CETC entry. This would better safeguard the integrity of the fund.

Even if the Joint Board does not move the ILEC ETCs off of rate-of-return based support mechanisms, it would deviate the least from principles of competitive and technological neutrality by simply limiting the CETC to the amount of support that it received per line at the time it entered the market, and not increasing CETC support as the ILEC lost lines. While this would lead to the ILEC effectively receiving greater per line support than the CETC, it would not reduce the incentives for the CETC to be efficient, as would an "own costs" mechanism.

The Commission should not adopt an "own costs" approach to support for CETCs that provide services that predominantly substitute for ILEC services. In the first

⁵¹ *In the Matter of Federal-State Joint Board on Universal Service*, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, CC Docket 96-45, at 37 (rel. September 29, 2000) ("The Task Force has recommended that per line support available to an incumbent Rural Carrier continue to change based on changes in costs. The Task Force has also recommended that once an additional ETC is designated and begins providing service in a Rural Carrier's study area, that per line support for both the ILEC and the CETC be frozen and grown by the annual RGF. . . . The Task Force believes that its recommended approach will continue to provide appropriate incentives for investment in rural America, while at the same time providing fair and reasonable procedures to facilitate competitive entry.").

instance, an “own costs” system essentially duplicates and applies to the CETC all of the economic disadvantages of ILEC rate-of-return regulation system. Under “own costs,” the CETC would be rewarded with greater support as its costs increased, and would receive less support as it reduced its costs. This is not the path forward to a more efficient and effective universal service system.

Moreover, the task of defining the “universal service costs” of a non-regulated carrier is particularly difficult because the CETC, particularly a cable company, builds a multifunctional network. If GCI were to try to determine the costs of its network in the same manner that ILECs do, it would have to start by assigning costs from all of its cable plant, facilities used commonly for voice, video and Internet service, to the voice service alone, irrespective of how those investments are treated today. Furthermore, because CETCs like GCI must raise its capital in the private markets and do not have the benefit of subsidization through NECA-type pooling, low cost RUS loans or rate-of-return regulation, any “own costs” calculation would have to account for these differences in risk as part of the cost of capital. Nor is it likely that USAC possesses sufficient administrative resources to cope with auditing CETC cost submissions, which have never been subject to the Uniform Systems of Accounts or other federal and state regulatory accounting rules. In short, while “own costs” support has been a convenient slogan, it is neither economically rational nor a practical way to structure CETC support.

E. Broadband

The reality today is that the high-cost support mechanism supports ILEC broadband deployments, particularly for rate-of-return carriers. Rather than simply winking at that non-competitively neutral practice, the Joint Board and the Commission

could make broadband service commitments part of the ETC eligibility criteria without adding broadband as a supported service.

To facilitate broadband deployment in high-cost areas, GCI proposes that the Commission should require, as a condition of eligibility, every ETC to be able to transmit through their last mile networks broadband at a mandatory minimum speed of 1 Mbps substantial majority of households within three years in the areas for which they are receiving support.⁵² As such, an ETC that receives universal service support, but does not design and provision networks sufficient to reach that target, is not serving its universal service function, failed to meet its universal service obligations, and should thus no longer receive funds. The Commission could, of course, institute a waiver process for this target, conditioned on an approved plan for achieving the goal.

This proposal would not only facilitate broadband deployment in areas that currently lack any broadband service, but would further the Commission's commitment to competitive neutrality. Through the current rate-of-return support methods, ILECs are in effect already getting support to upgrade facilities that provide broadband service, even in areas where cable companies or other providers already provide broadband service. As such, the Commission should make sure that such funds are being used to provide more universal broadband service by withholding future support from ETCs that fail to provide modest service at 1 Mbps to a substantial majority of households within three years.


⁵² Realizable speeds may vary depending on backbone capabilities. An ETC should not be penalized because its available backbone connections may not permit as fast a realizable broadband speed.

Conclusion

The 1996 Act embraces both competition and universal service, seeking to reform telecommunications regulation to ensure that competition can take root while making sure that all consumers have access to quality services at reasonable rates. GCI's experience, confirmed by economic theory, demonstrates that these two critical purposes work in tandem. Even in rural and remote areas, competition can bring consumers lower prices and increased choices. The Commission should keep this fundamental economic truth in mind as it undertakes long-overdue reform of the universal service high-cost support system. Rather than taking regulatory action that unnecessarily increases subsidies or favors incumbents over new entrants, the Commission should allow competition to rationalize rates, drive down prices, and serve the goals of universal service.

Respectfully submitted,

Tina Pidgeon
Vice-President –
Federal Regulatory Affairs
General Communication, Inc.
1130 17th Street, N.W., Suite 312
Washington, D.C. 20036
(202) 457-8812


John T. Nakahata
Brita D. Strandberg
Christopher Nierman
Harris, Wiltshire & Grannis LLP
1200 Eighteenth Street, N.W.
Washington, D.C. 20036
(202) 730-1300

Counsel for General Communication, Inc.

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