

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of)	
)	
Federal-State Joint Board Public Notice)	WC Docket No. 05-337
on the Merits of Using Auctions)	
To Determine High-Cost Support)	CC Docket No. 96-45
)	

COMMENTS OF TDS TELECOMMUNICATIONS CORP.

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SUMMARY

The idea of using “reverse auctions” to determine (i) the level of high-cost universal service funding, and (ii) the recipient of those funds, raises significant policy, economic incentive and legal questions that the Commission must consider before moving forward. It may be that reverse auctions would further the goals of universal service, as set forth in Section 254 of the Communications Act; it may be that those goals can be achieved in a manner that does not require an entirely new and staff-intensive compliance and enforcement mechanism; and it may be that auctions would result in delivering advanced telecommunications and information services in an efficient manner, but the Commission needs to dig deep on those questions and others to determine that auctions as a policy tool fit the specialized machinery of universal service support.

Here are some of the questions the Commission must address:

Will auctions improve delivery of universal service? Auctions are a policy tool—they are not a goal but a means to an end. The Commission should not proceed with reverse auctions unless it can be determined that this mechanism furthers, rather than retards, the policy goals of universal service.

Who is eligible to bid? A profound difference between spectrum auctions, where the Commission has deep experience, and reverse auctions for the USF, is the consequences of a system failure. If the spectrum auction system fails for whatever reason (e.g., Nextwave), the Treasury may be hurt somewhat, and consumers may not have the advantage of one more provider in the market, but they are not without service altogether. A failure in a reverse auction system, however, could result in no or poor basic telephone service for those unlucky Americans. Consequently, the Commission needs rigorous eligibility criteria upfront, to ensure that any party

submitting a bid is capable of delivering high quality access to advanced telecommunications and information services at rates comparable to urban area rates, as well as carrier of last resort requirements.

What service is being bid on? The Commission must establish clear, specific, and binding criteria defining the service that is being delivered to subscribers. Section 254 expressly requires “access to advanced telecommunications and information services”—that requirement must appear in any service definition. Notably, Section 254 makes no mention of “mobility.” Mobility may be a worthwhile policy goal, but it is not part of a universal service program. Of course, wireless carriers that can meet the service level requirements should be eligible to bid, but whether they offer mobility is simply besides the point under Section 254, and any reverse auction rules and procedures should reflect that legal reality.

Where are bidders going to provide service? Defining the appropriate geographic area for support is a critical step. In considering the possible options (State, franchise area, CMRS licensing maps, study area), study areas are clearly best at providing bidders and policymakers with a useful benchmark.

How will auctions be administered and enforced? Reverse auctions necessarily raise difficult questions of Federal and State coordination. The auctions should be conducted at the Federal level, but there is a role for States, which can continue to play a role in the ETC-designation process (provided that the State adheres to the Commission’s criteria). In addition, the Commission will need post-auction review and compliance efforts to ensure the service is being delivered, as well as complaint and enforcement mechanisms. Spectrum auctions for the most part did not require extensive post-auction compliance and enforcement procedures, because the economic interests of bidders were aligned with the Commission’s

interests—getting spectrum utilized quickly. The same cannot be said for reverse auctions—in fact, the economic interests may misalign. For that reason, the Commission must have in place a mechanism to ensure the services pledged to be provided at the specified price are being delivered.

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The Commission's effort to explore reverse auctions as a tool to strengthen the universal service fund (USF or Fund) merits serious debate and TDS Telecommunications Corp. (TDS)¹ is pleased to submit these comments to advance discussion of this important topic. TDS finds the Commission's reverse auction proposal intriguing and welcomes the opportunity to provide constructive assistance and criticisms through these comments.² Plainly, the *Notice* leaves many critical and difficult questions unanswered or unaddressed, some of which are raised in these comments. Though the Commission has experience with auctions in the spectrum context, the issues and concerns at stake here are far different. This topic is deeply complex and untried, and as such could potentially be devastating to universal service. Accordingly, TDS urges the Commission to proceed cautiously and analyze carefully the complicated questions and issues that reverse auctions raise.

¹ TDS Telecom is the parent company of 111 incumbent local exchange carrier (ILEC) subsidiaries serving over 700,000 local access lines in small and rural communities.

² Public Notice, *Federal-State Joint Board on Universal Service Seeks Comment on the Merits of Using Auctions to Determine High-Cost Universal Service Support*, CC Docket 96-45, FCC 06J-1 (rel. Aug. 11, 2006) (*Notice*).

From the outset, in evaluating reverse auctions, the Commission should state clearly and unambiguously its objective in using auctions. TDS submits that the only objective permissible under Section 254 would be to deliver universal service support in a more efficient manner but one that continues to be “specific, predictable and sufficient” to meet the goals of Section 254. Thus, reverse auctions need to be assessed on the ground of whether they help achieve one of the primary goals of the universal service program in the modern era: the promotion of investment in a nationwide ubiquitous infrastructure capable of living up to the goals of Section 254 of the Communications Act, including access to “advanced telecommunications and information services . . . in all regions of the Nation” for persons in rural areas and at prices reasonably comparable to those in urban areas. Auctions are a policy tool worth considering only if they promote these goals and are otherwise consistent with all of the statutory requirements of Section 254.³

I. REVERSE AUCTIONS ARE APPROPRIATE ONLY IF THEY FURTHER UNIVERSAL SERVICE POLICY GOALS.

In evaluating reverse auction proposals, the Commission must not lose sight that auctions are a means and not an end. Adopting them is therefore appropriate only if the Commission determines, based upon a well-developed record, that auctions further the broader policy goals of the universal service program.

More specifically, the Commission should remember that a primary policy goal of the universal service program is to promote *connectivity*. At its most fundamental level, the USF is intended to expand and improve the national telecommunications and information services network to which businesses and consumers connect. As Congress recognized in enacting

³ 47 U.S.C. § 254.

Section 254, a national network confers benefits not only on rural and high-cost customers and areas, but also on the public and the economy as a whole. By providing customers in high-cost areas with affordable access to the larger network, the USF facilitates the connection of millions of additional users, thereby creating invaluable network effects that provide benefits to all other businesses and customers on the network.

Realistically, the future of connectivity is broadband. As both President Bush and Chairman Martin have emphasized, increasing broadband penetration is one of the nation's top priorities.⁴ Broadband is capable of supporting the rising wave of advanced telecommunications and information services. With voice and video services increasingly shifting to IP-based platforms, and with numerous Federal, State and local government services and countless private sector employment opportunities offered exclusively online, it is more important than ever that the Commission create the proper incentives for investment in networks that support advanced telecommunications and information services. Similarly, it is important that the Commission not adopt policies that create disincentives to make these investments by, for instance, increasing the risks associated with the recovery of costs.

These principles—that consumers in rural and high-cost areas should have “access to telecommunications and information services” at affordable rates (or, to quote the statute, “at rates that are reasonably comparable to rates charged for similar services as in urban areas”)—come directly from Section 254. *See* 47 U.S.C. § 254(b)(3). Interestingly, Section 254 does not include in its detailed description of the key features of universal service the word or

⁴ *See, e.g.*, Roy Mark, “Bush Talks Broadband,” *Networking* (Jan. 20, 2006) (available online at <http://www.internetnews.com/infra/article.php/3578976>); Hon. Kevin Martin, Written Statement Before the Committee on Commerce, Science, and Transportation (Sept. 16, 2006) (available online at commerce.senate.gov/public/_files/MartinStatement.pdf).

concept of “mobility.” For these reasons, the universal service program, and any distribution mechanism such as reverse auctions, is statutorily obligated to focus on connectivity to telecommunications and information services rather than on mobility. Although mobility admittedly provides certain benefits and conveniences, the Commission should recognize that mobility is distinct from the goals of connectivity and that promoting the latter is the overriding purpose of the Fund.⁵ Accordingly, wireless carriers’ claims that USF support promotes mobility are really beside the point and should be irrelevant for purposes of the USF.⁶

This discussion is relevant to an analysis of the possible utility of auctions because the Commission should not lower the bar in defining what type of service should be supported simply to enable wireless carriers to participate. If they can provide the specified quality of service, reliability, access to advanced services, uniform coverage throughout an area, service response time, and similar features, then they should be eligible to participate in any auction. TDS must observe that many ETCs sought that regulatory status and USF support and then failed to deliver on their promises to provide service throughout a service area. In the *Nextel Holdings* proceeding, TDS documented how the carrier never built out the service area, despite claims to the Commission that it would.⁷ The Commission should not repeat that mistake here. The Commission should not relax the requirements on carriers simply to make more providers eligible for the auction. That surely would be the tail wagging the dog, and

⁵ If the Commission believes that mobility is a policy goal that needs support, then perhaps it could seek authorization from Congress to conduct a reverse auction for wireless service, which of course would be outside of the USF program.

⁶ In other words, it is the wireless carriers that, having been designated as ETCs, must conform to the universal service statute, not vice versa. The Commission is clearly free to promote mobility as an independent goal outside of the universal context. The fact remains that universal service is, by the terms of its animating statute, concerned with *connectivity*.

⁷ See TDS Comments, CC Docket No. 96-45 (May 7, 2004), at 7-9 (opposing Nextel Holdings’ petition for designation as an eligible communications carrier).

moreover, contrary to the requirements of Section 254 and the clear Congressional desire to not have revenue consideration drive the structure of the auction. *See* 47 U.S.C. § 309(j)(7)(A), (B).

II. REVERSE AUCTIONS WILL NOT FURTHER UNIVERSAL SERVICE POLICY GOALS WITHOUT CLEAR, SPECIFIC, AND RIGOROUS BIDDING CRITERIA AND QUALITY OF SERVICE OBLIGATIONS.

A. The Commission Should Clarify What Services Must Be Provided.

If the Commission implements reverse auctions for high-cost support, it must define in substantial detail all the features of the services that bidders must provide. This detailed and explicit definition, discussed in greater detail below, is necessary to enable the auction to function in a workable manner, where the only variable the Commission is assessing to pick the winning bid from eligible bidders is the price. Relatedly, bidders cannot make responsive, well-informed bids unless there is clarity about what services the winning bidder must provide. It would be unworkable if, within the same designated auction area, one bidder offers to provide voice-only services for \$X/customer while another bidder offers advanced services for \$Y/customer. To determine which bidder “wins,” the Commission would have to develop very detailed regulations *ex ante* to govern how these services should be compared. These regulations would inevitably require the Commission to quantify, in an objective, non-arbitrary manner, services that are qualitatively distinct. And the Commission would need to reconcile customer experiences such as billing, service response time, and speed of provision, across a wide variety of services.

Even assuming the Commission were capable of making such distinctions, the auctions would still be difficult to administer. Federal “on the ground” officials would have to conduct a side-by-side comparison of the services offered and subject them to the applicable regulations before determining who wins. In short, auctions could easily become administrative

burdens as well as sources for litigation—both outcomes that auctions are intended to avoid. The solution, if any, to these potential administrative burdens is for the Commission to define in substantial detail the services that must be provided throughout the designated area. For instance, to be eligible to win, the Commission could require all eligible bidders to provide access to advanced telecommunications and information services with a specific minimum capacity to customers throughout the high-cost area and meeting all applicable State quality of service and carrier of last resort requirements. Under this arrangement, at least, the only variable among the different bids from those persons deemed eligible (an important part of the bidding process) would be price.

B. The Commission Must Ensure Bidders Will Meet Service Obligations.

USF auctions are radically different than spectrum auctions in at least one respect: while a “failure” of the auction system in spectrum auction results in one less entrant in a market already served by multiple providers, a similar failure of a USF auction could terminate or terribly degrade connections for any number of unlucky Americans. Notwithstanding the enormous Commission time spent on the Nextwave affair—in which Nextwave won spectrum at auction only to see it tied up for years in bankruptcy, FCC, and appellate proceedings—consumers were only marginally affected. Other service providers were there to meet consumer needs while the Nextwave spectrum lay fallow, albeit likely at slightly higher prices.

By contrast, a similar debacle in a USF auction would severely harm consumers dependent on a wireline connection to be part of society and the economy. For this reason, the Commission must establish rigorous eligibility requirements prior to implementing any auction. Thus, before declaring any bidder eligible, the Commission should examine specific information including financial resources, technical capability, experience, and service history, to name a

few. In addition, and consistent with the standardized services described above, the Commission should require bidders to certify that they will provide, *inter alia*, access to advanced telecommunications and information services that meet minimum capacity standards.

Equally crucial is that the Commission develop a plan to monitor and enforce certification requirements. Without such a mechanism in place, certified ETCs could enter a particular coverage area and never build out in the manner promised. As discussed above in the context of the *Nextel Holdings* proceeding, this is not a theoretical concern. ETCs have promised build outs and have failed to deliver. In rural communities, the effect would be disastrous, and universal service would be set back by years. The Commission must guard against incentives for carriers to offer artificially low bids in high-cost areas. These low-ball bids could lead to a number of harmful policy consequences. For one, larger carriers might underbid smaller carriers and then proceed to serve only the lower-cost (and thus higher-margin) customers within a designated area. Similarly, carriers might offer low bids without having adequate resources to provide advanced telecommunications and information services or to comply with carrier of last resort requirements, as many rural carriers must do today. Finally, carriers may attempt to win bids by providing low-quality (and low-cost) services. These concerns could be addressed with rigorous eligibility requirements, with specific service obligations, and with ongoing oversight and compliance procedures.

To end the process of some carriers getting full USF support but underdelivering on the promised service, the Commission also should require bidders to provide service *throughout* the designated service area. As TDS has stated in other proceedings, one of the reasons why the USF system is in trouble is the Commission's failure to adhere to the

requirement that recipients serve an entire service area.⁸ The Commission will solve nothing with reverse auctions if this problem is not fixed. In fact, the situation could be dire if the other ETC decided to leave the market. That risk is not present in the current ETC program, but could surface under reverse auctions. Requiring service throughout a territory would remove the incentives to offer artificially low bids for carriers which intend to use reverse auctions to target only the lower-cost customers. Indeed, such a requirement is not only sound policy, it is required by Section 214(e)(1), which states that eligible telecommunications carriers (ETCs) “shall” offer service “throughout the service area.”⁹

Further, the Commission must not only ensure that bidders are capable and committed to providing high-cost service, it must also ensure ongoing compliance *after* the bidder receives USF support. Similarly to the measures discussed above, post-auction compliance reduces incentives for carriers to submit artificially low bids that are based on intentions to provide services to the relatively lower-cost customers in a service area. In addition, without such compliance requirements, carriers who win bids may have little incentive to make further investments, particularly the more expensive investments required to deploy broadband infrastructure. Without such preventive measures, there is little chance that an auction could advance the statutory requirements and policy goals of Section 254.

Without adequate mechanisms in place to ensure that universal service goals will be met in a reverse auction regime, the risk that such an approach will actually make the USF situation worse deserves weighty consideration. Designing such mechanisms, and measuring

⁸ See TDS Comments, *supra* note 7, at 5-6.

⁹ 47 U.S.C. § 214(e)(1).

and ensuring compliance, are no small tasks, and the challenges of designing and implementing them should be balanced against the uncertain benefits of reverse auctions as a policy tool.

III. REVERSE AUCTIONS MUST SATISFY STATUTORY REQUIREMENTS.

A. Can Auctions Provide “Predictable” and “Sufficient” Support?

In order to implement reverse auctions, the Commission must ensure that they are consistent with statutory requirements. Specifically, any reverse auction regime must be structured to satisfy the statutory requirements and policy goals of Section 254, particularly the requirement that USF support be “specific, predictable, and sufficient . . . to preserve and advance universal service.”¹⁰ Accordingly, the Commission should carefully consider a number of important questions in evaluating any proposed auction proceedings.

1. Predictability

One particular challenging question is whether an auction regime can provide “predictable” support pursuant to statutory requirements. Does an auction result in “predictable” support for the service provider? For the customer? The Commission needs to examine this statutory requirement from the perspective of both the public and individual service providers, since both entities have a need for predictable support. The public needs assurance that support will be forthcoming to start a business and stay in their home; a service provider needs predictability to make the necessary investment in infrastructure over some period of time. This raises another question: What is the appropriate time period in term of years for support to be given to a winning bidder? If the term is too short, then a provider has little incentive to invest in advanced infrastructure. If it is too long, and there is more than one ETC in the market, the

¹⁰ 47 U.S.C. § 254(b)(5).

losing bidder may have an incentive to exit the market and abandon equipment. A period that is too long also could have a negative impact on investment, especially in the latter years of a term.

2. Sufficiency

The Commission must also determine whether reverse auctions provide “sufficient” support. If, for instance, the auctions were to drastically reduce support to the point that universal service goals were not being achieved, they would likely be subject to court challenge.¹¹ In addition, even if the total USF support remains relatively constant, support could be deemed “insufficient” if it were reallocated in a way that deprived high-cost areas of the monies necessary for service providers to invest in advanced service infrastructure.

B. Do Auctions Meet the Statutory Requirement to Enable Access to Advanced Information Services Networks?

In addition to the “predictable” and “sufficient” requirements, Section 254 also requires the Commission to preserve *and advance* universal service support for access to telecommunications and information services networks in rural and high-cost areas.

Specifically, Section 254 defines universal service thusly:

(2) ACCESS TO ADVANCED SERVICES.—Access to advanced telecommunications *and information services* should be provided in all regions of the Nation.

(3) ACCESS IN RURAL AND HIGH COST AREAS.—Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications *and information services*, including interexchange services and advanced telecommunications *and information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

¹¹ See, e.g., *Qwest Communications International, Inc. v. FCC*, 398 F.3d 1222, 1232 (10th Cir. 2005) (“*Qwest II*”).

Given this statutory mandate, reverse auctions are only appropriate if they are structured in a way that ensures that customers have greater, rather than less, access to advanced services including information services. The Commission needs to take several steps to achieve this statutory objective, including (as discussed above) by defining the services to be supported as including connectivity to telecommunications and advanced information services networks. In short, auctions will meet this statutory objective only if they result in a level of support that allows carriers to make the infrastructure investments necessary to provide affordable advanced services.

IV. IF ADOPTED, REVERSE AUCTIONS WOULD HAVE TO BE IMPLEMENTED PRIMARILY AT THE FEDERAL LEVEL, RAISING SIGNIFICANT ISSUES OF UNIFORMITY AND PREEMPTION.

The *Notice* seeks comment on the respective roles that Federal and State officials should play in the administration and oversight of the auction process.¹² Although both Federal and State officials have important roles to play, there are several reasons why a reverse auction regime would have to be implemented and administered primarily at the Federal level, by the Universal Service Administrative Company (USAC) or some newly designated reverse auction division at the Commission. The most obvious reason is the strong need for procedural uniformity. Without uniform auction procedures in place, bidders would potentially be subjected to fifty different types of auctions with fifty different procedures. The transaction costs associated with participating in, and complying with, such a diverse range of auction proceedings

¹² *Notice*, ¶ 7.

would be high, and auctions would be less efficient. Also, local pressures could distort the auction process in ways that undercut the overall purpose of the program.¹³

That said, TDS believes that States can play a role in awarding USF support under a reverse auction regime. We believe the Commission should limit bidding to designated ETCs. (It bears emphasis that ETC status would be a necessary condition; it would not be sufficient, however, and should not be a complete substitute for the rigorous eligibility requirements discussed above.) States have ETC designation responsibilities, and they would therefore play an important part in determining the “winners” of any auction insofar as all bidders would have to meet this basic qualification. However, as TDS has stated in other proceedings, that process has flaws today, since some States do not apply the ETC eligibility requirements as they should, and the Commission itself has not set a high enough standard. Thus, the Commission must first fix the ETC eligibility criteria and State implementation thereof before it can be relied on in the auction process. Without this cure, the Commission is simply carrying an old disease into a new host.

V. REVERSE AUCTIONS IF ADOPTED SHOULD ONLY BE IMPLEMENTED IN AREAS WHERE BIDDERS CAN DETERMINE THEIR COSTS.

As the *Notice* recognizes, one of the key questions the Commission must address in designing auction procedures is the “appropriate geographic area for support.”¹⁴ Two considerations should guide the Commission in making this decision. First, the Commission should use a geographic area that would encourage participation by firms able and willing to

¹³ TDS has commented that some States have not administered the ETC eligibility criteria in a rigorous manner because of these kinds of local pressures. *See* Petition for Reconsideration, CC Docket No. 96-45, at 12-16 (June 24, 2005). Similar concerns about local pressures distorting the program could be lodged against the concept of universal service block grants to States.

¹⁴ *Notice*, ¶ 8.

provide service to rural and high cost areas. As an extreme example, defining the geographic area as the continental United States would shut out virtually every provider.¹⁵ Second, auctions will only succeed if bidders can accurately and rationally determine the costs of providing service prior to their bids. If bidders cannot determine these costs, the auction will inevitably produce inefficient results because the price signals for entry and persistence in the market will be skewed. Bidders cannot rationally plan to provide sustained service in an area for the amount of subsidy for which they bid if they cannot discern the costs of providing service. For this reason, it is important that the Commission delineate geographic areas in a way that makes it feasible for bidders to determine their costs accurately.

To identify the appropriate geographic area, the Commission should assess each possible option. One possibility is to conduct auctions at the state level. Bidding over such a large geographic area would likely disqualify a number of small and rural carriers that currently provide high-cost service. Such carriers lack the resources of larger carriers, and will face artificially high minimum bids in light of their inability to realize economies of scale. In addition, given the size of a statewide bidding area, carriers' bids would inevitably be based on cost averaging across the state. Such cost averaging would be inappropriate: it would combine high-cost service areas with vastly different costs based on diverse geographic or topographic characteristics and ensure that presently uncovered high cost areas would remain unserved. Finally, carriers do not generally maintain costs records at the state level. Implementing auctions at this level would therefore require them to calculate from scratch their estimated costs, at considerable time and expense (again, this requirement is particularly burdensome for smaller

¹⁵ No CMRS or wireline provider today offers ubiquitous coverage to the country.

carriers). Even assuming time and money are no concern, however, these calculations would be virtually impossible for carriers whose high-cost service areas span state lines.¹⁶

Another possibility, given the likely interest of cable providers in bidding in reverse auctions for universal service, is a division along local cable franchise areas. This too is problematic, most obviously because two of the likeliest bidders—wireline and wireless carriers—have no basis whatsoever for determining their costs at the local cable franchise level.¹⁷ In addition, since cable operators are not regulated on a cost-related basis, they may not currently maintain their costs at the present level.

A third option is wireless licensing areas, but this option is also subject to similar problems. Once again, two likely industry bidders—wireline and cable providers—have no basis for knowing what their costs would be for offering service in these areas. And the wireless industry is in no better position—since that is what wireless carriers have repeatedly told the Commission, that they cannot determine the costs of providing high-cost service in their licensing areas. Indeed, this assertion is the basis for allowing wireless carriers as ETCs to recover USF support based on the ILECs' costs.

The remaining option is to designate study areas as the appropriate geographic area for purposes of bidding. Although it is not a perfect solution, implementing auctions at the study area level mitigates, if not eliminates, many of the problems referenced above. For one, the universal service program was initially constructed around study areas, and carriers have long and extensive experience with these geographic areas. ILECs, for instance, have been

¹⁶ All of these problems would, obviously, be exacerbated if the Commission designated the entire nation as the appropriate geographic level for purposes of the auction.

¹⁷ Certain States have State-wide cable franchise arrangements. For the reasons discussed above, however, States make poor bidding areas in the reverse auction context.

calculating their costs (and wireless carriers have appropriated these numbers) at the study area level for many years. In addition, bidding carriers from any industry sector could more rationally and accurately ascertain their costs at the study area level since they would have a benchmark based on the ILECs' costs that are a matter of public record.

* * *

The list of issues and questions discussed above is not complete. Large and small issues remain that must be considered and weighed before the Commission can decide that reverse auctions are a useful policy tool to implement its statutory mandate of providing consumers in rural and high cost areas with access to advanced telecommunications and information services in an efficient manner. TDS looks forward to developing with other commenters and the Commission a comprehensive list of issues raised in this connection and to weighing the alternatives for addressing them.

VI. THE RECORD DOES NOT SUPPORT ALTERING EITHER THE CURRENT COST MECHANISM OR THE DEFINITION OF "RURAL PHONE COMPANY."

In addition to its request for comments on reverse auctions, the Joint Board invited interested parties to submit comments that would supplement the record of the August 2004 *High-Cost Proceeding*.¹⁸ TDS welcomes this opportunity, precisely because the record lacks support for drastic change, just as it did in 2004. Little if any evidence has surfaced since the earlier proceeding indicating that the embedded costs method is deficient, or that a forward-looking model could furnish the sort of "specific, predictable, and sufficient" universal support mechanism envisioned under 47 U.S.C. § 254(b). Similarly, it remains the case that defining

¹⁸ *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, Public Notice, CC Docket No. 96-45, 19 FCC 16083 (2004).

“rural telephone company” by the nature of the area serviced, rather than by the aggregate number of lines, best serves the goals of universal service.

A. Forward-Looking Costs

The existing mechanism for assessing costs remains effective and no workable forward-looking costs model has been developed that meets the requirements of 47 U.S.C. § 254(b).

The previous two decades have seen general increases in rural telephone and broadband subscribership at service rates comparable to those paid in urban areas.¹⁹ One reason for this positive trend is that the current embedded cost model, unlike the proposed forward-looking model, captures every factor affecting a carrier’s costs of providing service to rural areas. Therefore, a carrier has ample incentive to invest in network upgrades, which in turn improve service quality and facilitate the introduction of broadband and other advanced services to rural customers.

In contrast, a forward-looking cost mechanism is likely to discourage investment. Variation in geographic, economic, and regulatory conditions among and within rural areas make cost prediction difficult and error-prone. Six years ago, having acknowledged that even small variations of input can have large repercussions under a rural forward-looking cost model, the

¹⁹ See *Telephone Subscribership in the United States (Data Through November 2005)*, Industry Analysis and Technology Division, Wireline Competitive Bureau, FCC, at 6 (rel. May 12, 2006). Of course, there are clear and obvious problems with the data collection methodology used in the Commission’s studies, most notably that it adds an entire zip code merely if any resident of that zip code adds service. See *Broadband Deployment is Extensive Throughout the United States, but It Is Difficult to Assess the Extent of Deployment Gaps in Rural Areas*, Report to Congressional Committees, Government Accountability Office, GAO 06-426, at 3 (rel. May 2006). TDS’s internal numbers show a strong increase in DSL-capable lines, though not necessarily at the same pace suggested by the Commission’s study.

Rural Task Force was unable to agree upon the appropriate factors and data.²⁰ There has been no meaningful progress on the model since.

With no guarantee that its financial expectations will be met, a carrier will understandably hesitate before making the sorts of investments necessary to further universal service goals. A forward-looking model impedes investment for an even simpler reason: a carrier would receive the same subsidy in a given term whether it made necessary upgrades or not.

Nor is this an arena where the Commission should experiment. The administrative burdens involved in switching models are enormous. Not only would the Commission have to do what the Rural Task Force could not, i.e., agree upon the correct inputs, the Commission would have to develop extensive transition machinery. Meanwhile, regulators in every State would need to reevaluate rates, and carriers would have to learn about and implement the new rules, expending resources best spent on development.

In the absence of significant evidence that the embedded costs model is inefficient or otherwise dysfunctional, and with no practical alternative, the Commission should not change the way it determines costs.

B. “Rural Telephone Company”

Like the embedded cost mechanism, the current definition of “rural telephone company” succeeds by accounting for the realities of rural service. In addition to indications that Congress intended its statutory definition of rural telephone company to play a role in the

²⁰ *Rural Task Force White Paper #3: Alternative Mechanisms for Sizing a Universal Service Fund for Rural Telephone Companies* 23 (2000) (available at <http://www.wutc.wa.gov.rtf>).

allocation of universal service support,²¹ the definition captures the variation and costs that inhere to this special market, irrespective of the size of the carrier.

Arguments that the definition over-includes assume without support that large rural carriers and/or holding companies benefit from economies of scale and density typical in urban markets. They do not, or at least not to anywhere near the same extent.²² For many practical and historical reasons, individual subsidiaries are often operated as separate companies. Furthermore, rural carriers by definition lack lucrative low-cost markets with which to offset costs.

²¹ See TDS Comments, CC Docket No. 96-45, at 14-15 (Oct. 15, 2004). Cf. 47 U.S.C. § 214(e)(5) (defining “service areas” within which ETC’s may be designated as “a geographic area established . . . for the purpose of determining universal service obligations and support mechanisms” by reference to “rural telephone companies”).

²² Meanwhile, the existing embedded cost mechanism takes into account the extent (if any) to which economies of scale operate.

CONCLUSION

TDS is pleased the Commission is seeking to strengthen the universal service program. Before the Commission decides that reverse auctions are appropriate tools for this important goal, however, it should carefully consider the potential consequences from a statutory and public policy perspective. Reverse auctions require careful calibration, solid information, and the rigorous enforcement of clear standards. A flawed reverse auction mechanism could have devastating consequences for universal service, and for the Nation's consumers.

Respectfully submitted,

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