BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its own motion, to make adjustments to its high-cost distribution mechanism and make revisions to its reporting requirements.	))))))	**Application No. NUSF-108** **Progression Order No. 3**

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Nebraska Public Service Commission

REPLY COMMENTS BY
CHARTER FIBERLINK – NEBRASKA, LLC,
TIME WARNER CABLE INFORMATION SERVICES (NEBRASKA), LLC AND COX NEBRASKA TELCOM, LLC.

In accordance with the Nebraska Public Service Commission's (the "Commission") *Order Seeking Comment* dated March 19, 2018, Charter Fiberlink – Nebraska, LLC and Time Warner Cable Information Services (Nebraska), LLC (collectively, "Charter"), and Cox Nebraska Telecom, LLC ('Cox") take this opportunity to provide Reply Comments in the above captioned proceeding.

In the Reply Comments below we explain that:

- Replacing the Benchmark Cost Proxy Model ("BCPM") with *any* variant of the Connect America Cost Model would accomplish little more than replacing the obsolete with the overstated;

- Competitive bidding systems that permit any provider the opportunity to request support, with specific proposals judged by their relative merit, are preferable to administrative systems that give preference to incumbents;

- Accountability can best be achieved through network verification. Accounting-based approaches, such as the NUSF-EARN report, depend upon cost allocations that have never been updated to reflect new technologies and contemporary revenue streams, such as Internet access and video; and

- There is no reason to resize the Nebraska Universal Service Fund ("NUSF") until the Commission has fully reformed the NUSF to *directly* link its support mechanism to specific proposals to extend (or maintain) networks, accompanied by enforcement mechanisms to ensure promised expansions are met, and until the federal USF more fully transitions to its auction-based approach.

We remind the Commission that the first tranche of federal auction funding – $200 million per year for 10 years – will begin this summer.[1] In addition, starting in 2021, an additional $1.7 *billion* per year will become available. It will not be until these auctions have been implemented that any residual need for additional state funding will be apparent. This does not mean, however, that the Commission should sit idle while these federal programs are implemented. Rather, we agree with the Rural Telecommunications Coalition of Nebraska ("RTCN") that the Commission should open a rulemaking to develop a more robust and transparent grant system to which the existing BCPM-based funding can be transitioned.[2]

The Commission Should Not Reform the NE USF
<u>Funding/Accountability System Based on a Cost Model</u>

The Rural Independent Companies ("RIC") is correct that the BCPM currently in use by the Commission is obsolete.[3] We strongly disagree with RIC, the however, that a State Broadband Cost Model ("SBCM"), derived from the FCC's Connect America and Alternative Cost Models ("CAM" and "ACAM", respectively), be used in its place.

Charter has previously identified the significant flaws in the cost-model approach and the known problems with the CAM, which include:

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1 *See* Comments of Charter at 2-3.

2 RTCN Comments at 5. We recognize that our recommendation that BCPM funding be transitioned to a merit-based system likely goes beyond RTCN's intention, given RTCN's desire to protect funding for *existing* facilities. We do understand, however, that where a carrier has constructed a network to areas not served by an unsubsidized competitor based on an expectation of continuing subsidy there *may* be a justifiable need for support. The possibility that continuing support may be needed should not create a presumption that *all* networks require perpetual support.

3 *See* Comments of the Rural Independent Companies, NUSF-111, January 30, 2018 at 12-13.

- Recipients of model-based support have reported to the FCC that there are fewer actual locations than the cost model assumed;[4]

- The Rural Broadband Experiments demonstrated that competitive bidders were willing to construct faster networks at much lower (by half) cost than estimated by the CAM;[5]

- The cost model assumes a single technology (fiber) and a single architecture (premise to incumbent wire center) when it is likely that alternative technologies and architectures are a more efficient approach;[6] and

- The fact that roughly 94% of the CAM-based offers (excluding Verizon) were accepted by the ILECs indicates that the model likely overstated costs (and was, therefore, unnecessarily generous in its support).[7]

The fact that the SBCM considers only one technology and only one architecture (fiber to the home from the existing incumbent wire center) is sufficient to doom its accuracy. Real networks are not so limited, as RTCN explained:

> RTCN members have recognized it is not always cost-effective or sensible to deploy fiber to remote areas where there are few residents - not uncommonly only one potential subscriber. People move. New technologies develop. Subscribers' preferences and needs change. Recognizing these facts, RTCN members have prudently deployed a variety of technologies to serve their subscribers.[8]

In contrast to the RTCN, RIC argues that the SBCM can be used not only for disbursements but as a key part of *accountability*.[9] In our view, the SBCM is a costly distraction.

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4 Comments of Charter, NUSF-111, January 30, 2018 at 8.

5 *Ibid* at 9.

6 For instance, the RTCN indicates that its members have "deployed fiber and *other facilities* capable of providing broadband at 25/3 speeds throughout their territory." RTCN Comments at 7. Emphasis added.

7 *See* Pre-Filed Reply Testimony of Joseph Gillan on behalf of Charter, Application No. NUSF-100, April 21, 2017, pp. 20-21.

8 RTCN Comments at 10.

9 RIC Comments at 4. Although RIC also adopts a build-out requirement and verification (discussed later), the "cost" of the build-out will be that assumed by the model, not actual experience:

> In estimating the costs associated with the build-out plans and commitments, the ROR [rate of return regulated] carriers will utilize cost data provided by the SBCM. These

The far better approach is to let companies compete for USF support. Indeed, we fully expect that the July CAF auction – where carriers will compete with one another to serve those same census blocks that the CAM identified as costly – will further demonstrate that the CAM model overestimates the cost of rural broadband service. The factors listed above indicate that actual networks cost less than CAM asserts – which is *why* so many ILECs choose the CAM and ACAM-based offers.

It is also useful to note the very different perspectives of the RIC and RTCN. RIC seeks a significant increase in the fund, and the elimination of a key filing (the EARN report) that provides oversight (although limited oversight, as we explain later). Perhaps this is because the RTCN members have committed more to providing broadband in the areas that they serve. According to federal data, at the end of 2015, the RTCN members had deployed 10/1 Mbps broadband to over 86% of their residential housing units, while the RIC companies offered 10/1 Mbps broadband service to only 75% of the residential housing units in their territories.[10] The mere fact that RIC is farther behind, however, does not mean that the support they have received is inadequate. Rather, it raises the fundamental question: how has the support been spent? We estimate that the RIC members have received over $250 million in federal and state USF support in the past five years alone.[11] What has Nebraska received for this quarter of a billion dollars?[12]

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new accountability measures will supplant and replace continued use of the NUSF Earn form.

10 https://transition.fcc.gov/wcb/Revised%20coverage%20data.xlsx.

11 Federal USF support is estimated from HC01- High Cost Support Projected by State by Study Area (annualized from the 4Q filing) available at https://www.usac.org/about/tools/fcc/filings. NE USF Yr14 support NUSF-108 High Cost Support Distribution, available at http://www.psc.nebraska.gov/ntips/ntips_nusf.html.

Prior year disbursements were obtained using the "Wayback machine" at http://archive.org/web/. NE USF Yr13 support was not available from any date archived and was estimated as the midpoint between Yr12 and Yr14 disbursement levels.

Accountability Requires Verification

In most instances, a merit-based system of competing proposals will result in new network construction. In these circumstances, accountability depends upon verification – have the promised networks been deployed? This is the inherent advantage of a merit-based disbursement system that ties support to specific proposals. In such a system, the Commission knows what the public is funding at the outset. As a result, verification need not consider estimated future costs, or allocations of historic costs, to determine whether the support was properly used. Funding new network construction does not mean that carriers should not be given the opportunity to compete for subsidy with proposals to maintain and operate existing facilities. We recognize that there may be times when subsidy is necessary to ensure existing facilities remain operational, but such proposals should be proven to be cost-effective rather than simply assumed to require subsidy.

Even RIC agrees that validating network is fundamental to reform.[13] The core differences between what RIC suggests and our view here is that (a) providers *other* than rate-of-return ILECs may compete for support and (b) through that competition, the Commission and the public have greater confidence that the Commission collects and redistributes directly benefit rural Nebraskans' access to cost-effective broadband solutions.

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[12] Commission Rhoades expressed similar reservations in her Dissenting Opinion to the NUSF-108 Order on Reconsideration, saying billions of dollars in subsidies have been distributed to Nebraska carriers through high-cost support, and carriers should be able to demonstrate that those funds have been used as intended. NUSF-108 Order on Reconsideration, entered Feb. 6, 2018, p. 3.

[13] RIC Comments at 6:

> RIC's proposed accountability mechanism represents a process in which a ROR carrier pre-identifies the actual project(s) that will be built during a specified time period, to the extent that the NUSF High Cost Program funding is provided, and following completion of the build-out the ROR carrier confirms to the Commission the accomplishment of the project(s). This build-out can be audited by the Commission to verify the accuracy of the carriers' reporting.

We again emphasize the importance of the Commission monitoring the FCC's July CAF auction to observe, with real data, the types, cost and number of proposals that compete for the $200 million per year, including comparing the actual requests for support to the level of support estimated by the federal version of the SBCM (*i.e*., the Connect America Cost Model). The July CAF auction will provide a real-world test as to whether the model can accurately determine the true cost to deploy rural broadband.

Engineering validation is fundamentally superior to accounting-based analyses (such as the embodied by the NUSF-EARN report) because it is tangible: Is the network operating as promised, and capable of serving the locations as promised? But confirming that network has been constructed is not sufficient unless it is part of a process that constrains the level of support devoted to the construction. In RIC's view, the Commission should place its trust in the SBCM. In our view, the Commission should allow competition among proposals to eliminate waste and excess funding.[14]

Interestingly, the EARN report is both recommended (RTCN) and disfavored (RIC) by the rural rate-of-return carriers. RTCN goes so far as to recommend that all carriers (or at least presumably those receiving support) should be required to complete the EARN report,[15] while RIC recommends that the form be discontinued entirely.[16] We believe that the EARN report is an artifact of a flawed and obsolete system. The EARN report does not determine *how* support is used, it simply measures "intrastate" earnings. Significantly, the intrastate earnings calculated

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14 Competitive bidding has been used to eliminate waste and excess funding in government contracting for a very long time with good reason. There is no reason not to treat the disbursement of NUSF monies collected from the public to existing or aspiring rural carriers any differently than one would treat any other government contract.

15 RTCN Comments at 10.

16 RIC Comments at 6.

by the NUSF-EARN report are wholly dependent upon the allocations used to determine intrastate financial performance.

One of the critical flaws in the EARN approach is that the cost allocations that underlie the report are hopelessly obsolete. Specifically, the interstate/intrastate cost allocation of outside cable – *i.e.*, the fiber that is being deployed for broadband services – was frozen in 1982 when the only interstate service was long distance toll. Today, there is a fundamental mismatch in that only 25% of the cost of the fiber is allocated to the interstate jurisdiction, while 100% of the broadband revenues are treated as interstate. The result is that any analysis of the intrastate earnings of a rate-of-return carrier will be artificially depressed because 75% of the cost of the fiber will be shown in the intrastate analysis, while 0% of the Internet and video revenues made possible by the fiber will appear.[17] This mismatch means that the intrastate earnings reported by the EARN is effectively meaningless.

The best solution is to divorce the Commission's USF system from the accounting costs of rate-of-return carriers and transition to a system that allows for any carrier to seek support, with a chance of success determined by the merit of the proposal and not the legacy nature of its business. In other words, create an auction system that directly ties support to performance.

Although RTCN is generally more reasonable in its comments than RIC, it does seek support even in instances where it faces competition:

> A clear distinction needs to be drawn between system upgrades and new deployment. The presence of unsubsidized competing carriers should not affect support for system upgrades in ILECs' territories.[18]

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17 In addition, many rate-of-return carriers use affiliates to provide internet access and video services, which makes cost allocation of shared facilities that much more complicated.

18 RTCN Comments at 7.

Notably, the RTCN comments offer no justification for providing subsidy so that an ILEC may *upgrade* its network to compete with an unsubsidized competitor. Indeed, the sentence immediately prior states:

> It would be appropriate and fiscally responsible for the Commission to disallow support for new deployment in areas where another carrier is currently providing telecommunications (voice) and information services that meet the definition of broadband.[19]

It would be equally "appropriate and fiscally responsible" for the Commission to deny funding an ILEC seeking to *upgrade* its network to better compete with an unsubsidized competitor. Said more directly, it would be completely *inappropriate* – and fiscally *irresponsible* – to ask Nebraskans to pay into a NUSF to fund an ILEC's competitive response. As CTIA explained:

> There is no basis to provide a subsidy for broadband service in an area where no subsidy is needed, as demonstrated by the entry of an unsubsidized provider. This restriction is a necessary step to protect Nebraska consumers from excessive NUSF costs.[20]

It Would Be Fiscally Irresponsible to
<u>Increase the NUSF Based on Current Information</u>

The centerpiece of the RIC comments (as with its comments in the NUSF 111 proceeding) is that the NUSF should be increased to $60 million dollars per year.[21] In our view, it is not that the fund is demonstrably insufficient – indeed, we have explained repeatedly that the SBCM cost model cannot be used to reach that conclusion – the problem is there is no accountability, choice or pressure for efficiency in the system as structured today. There is nothing in a BCPM-based (or SBCM-based) disbursement scheme that ensures that scarce public

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19 *Ibid.*

20 CTIA Comments at 3.

21 RIC Comments at 2.

dollars will be directed to the most efficient proposals, matched with an accountability process (such as network verification) that confirms the promise is being kept.

One perspective on the efficiency of the existing system is to compare the level of support provided to rural ILECs to the extent of their broadband deployment. In other words, is there a discernible pattern that links *outcome* (deployment) to the *input* (subsidy)?

To provide this perspective, we prepared the attached table based on the most recently publicly available measures of broadband deployment in the territories served by rural rate-of-return ILECs in Nebraska. This data was released by the FCC during its development of the ACAM and is for 2015.[22] The FCC deployment data provides an estimate of the number of households that the ILEC (or its affiliate) offers 10/1 Mbps broadband in its territory (as well as the total number of households in its area). The table then compares this deployment measure to our estimate of the federal and state high cost (combined) support received by these rate-of-return ILECs (per housing unit/month).[23]

It is not the purpose of the attached table to document the *existing* status of broadband deployment in rate-of-return carriers. Rather, the table takes the most current publicly available information on deployment (2015) and compares it to the combined federal and state USF payments at the time to show that there is no discernible pattern that links outcome to expenditure.

For instance, there are seventeen (17) rate-of-return ILECs that had deployed 10/1 Mbps service to 100% of their territory by the end of 2015. Among these carriers, however, the

22 *See* https://transition.fcc.gov/wcb/Revised%20coverage%20data.xlsx.

23 The table estimated the combined support using the following sources. The NUSF high-cost support component was drawn from the NUSF Yr11 disbursements, available at http://www.psc.nebraska.gov:80/ntips/ntips_nusf_high_cost.html, from May 30, 2015 (using the "Wayback machine" at http://archive.org/web/). The federal USF support was drawn from HC01- High Cost Support Projected by State by Study Area - 4Q2015.xlsx (annualized) available at https://www.usac.org/about/tools/fcc/filings/2015/q4.asp.

average monthly support payment per housing unit ranged from $ 12.33/month (Blair) to $272.72/month (Hartman Telephone Exchange). At the other end of the spectrum, Great Plains Communications had deployed 10/1 Mbps broadband to only 57% of the housing units in its territory (2015), despite receiving over $41.65 per month support. The central lesson from the attached table is that the existing system does not appear to produce the desired outcome (universal broadband service) in a manner that ensures support is directed to the areas and providers where it can do the most good.

Conclusion

The Commission can never be assured that its NUSF support payments achieve the most cost-effective broadband availability in areas that are not already served by an unsubsidized competitor until it delinks its system from cost models and ILEC-defined outcomes. As with the federal system, the Commission should instead transition to a process that permits open proposals, with a ranking system based on merit. Such an approach may reveal that support payments should be shifted from some rate-of-return carriers to others, or it may demonstrate that third-parties that are *not* rate-of-return carriers are better-positioned to provide broadband service to these unserved areas. One thing is certain: Any system that is based on an ILEC-defined cost model is not capable of achieving any of these objectives.

In NUSF-99, the Commission determined changes to the NUSF were warranted for the distribution of NUSF support to price cap companies.[24] The Commission should proceed with making changes to the rate of return companies as well. We encourage the Commission to

[24] An Order entered in NUSF-99, P.O. 1 on September 1, 2015 required price cap companies to use 50% of NUSF support for broadband grant projects. That amount has since been increased to 80%.

proceed making much needed changes to the now twenty-year old NUSF to bring improved openness, transparency and efficiency to the program.

Respectfully submitted this 12th day of April 2018.

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Comparing 10/1 Broadband Deployment to Support Levels (2015)

Incumbent Local Exchange Carrier	Percentage of Housing Units	Total Support/ Household/month
Hartman Tel Exchange Inc	100%	$272.72
Three River Telco	100%	$188.01
Wauneta Tel Co	100%	$165.95
Glenwood Tel Member	100%	$161.35
Benkelman Tel Co	100%	$159.71
Stanton Telecom Inc.	100%	$153.30
Plainview Tel Co	100%	$132.83
Clarks Telecom Co.	100%	$126.14
Hartington Tel Co	100%	$121.70
Henderson Co-Op Tel	100%	$114.48
Northeast Nebraska	100%	$93.36
Se Nebraska Tel Co	100%	$75.21
Keystone-Arthur Tel	100%	$63.99
Hershey Coop Tel Co	100%	$57.71
Hamilton Tel Co	100%	$30.63
Arlington Tel Co	100%	$18.74
Blair Tel Co	100%	$12.33
Hemingford Coop Tel	99%	$178.89
Arapahoe Tel Co	98%	$90.58
Cambridge Tel Co - NE	96%	$124.61
Consolidated Telecom	90%	$53.52
Consolidated Tel Co	85%	$56.99
Consolidated Telco	85%	$39.27
Curtis Tel Co	78%	$68.33
Diller Tel Co	78%	$205.20
Nebraska Central Tel	68%	$36.57
Rock County Tel Co	67%	$16.99
K & M Tel Co, Inc	63%	$97.30
Hooper Tel Co	62%	$32.34
Eastern Nebraska Tel	61%	$24.12
Great Plains Communications	57%	$41.65
Elsie Comm., Inc.	0%	$128.67
Cozad Tel Co	0%	$90.14
Sodtown Tel Co	0%	$65.97
Dalton Tel Co, Inc	0%	$50.27
Pierce Tel Co	0%	$28.03

Certificate of Service

The undersigned hereby certifies that on this 12th day of April, 2018, five copies of the Joint Reply Comments of Charter Fiberlink - Nebraska, LLC and Cox Nebraska Telcom, LLC in Application NUSF-108 were hand-delivered to the Nebraska Public Service Commission, 300 The Atrium, 1200 N Street, Lincoln NE and a copy of the same has been e-mailed to the following:

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