BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its Own Motion, to Administer the Nebraska Universal Service Fund High Cost Program	Application No. NUSF-99

REPLY COMMENTS OF CITIZENS TELECOMMUNICATIONS COMPANY OF NEBRASKA d/b/a FRONTIER COMMUNICATIONS OF NEBRASKA, QWEST CORPORATION d/b/a CENTURYLINK QC, UNITED TELEPHONE COMPANY OF THE WEST d/b/a CENTURYLINK, AND WINDSTREAM NEBRASKA, INC.

I. Background and Introduction

The Nebraska Public Service Commission ("Commission") opened the instant proceeding on October 15, 2014 to investigate the creation of a separate distribution mechanism of Nebraska Universal Service Fund ("NUSF") high cost support for price cap companies. The nature and level of Federal Universal Service Fund ("FUSF") support for all carriers is changing due to the Connect America Fund ("CAF"), most significantly, in the near term, for areas served by price cap companies with the implementation of CAF Phase II. As a result, by order issued October 15, 2014, the Commission opened this docket to investigate potential changes to distributions from the NUSF to make those distributions complementary to CAF support. On June 16, 2015 the Commission issued an Order Seeking Further Comment and Setting Hearing. In the latter Order, the Commission laid out a framework for a new NUSF high cost distribution mechanism for the areas served by price cap companies. On June 30, 2015, parties filed initial comments on the Commission's proposal. Citizens Telecommunications Company of Nebraska d/b/a Frontier Communications of Nebraska, Qwest Corporation d/b/a CenturyLink QC, United Telephone Company of the West d/b/a CenturyLink, and Windstream Nebraska, Inc. (collectively, "PC Carriers") respectfully provide these reply comments in response to the initial comments.

The PC Carriers' primary focus in this reply is on those commenters (collectively referred to as the "Objecting Commentors") who advance the recommendation that NUSF support should be discontinued for areas that receive CAF support.[1] As discussed below, this recommendation is based on

[1] Initial Comments of AT&T, page 3 (suggesting the possibility of duplicative NUSF and CAF support for the same areas or facilities); Initial Comments of Sprint, page 2 (asserting receipt of NUSF and CAF is duplicative); and

several flawed premises and should not be accepted. The PC Carriers also briefly address why CAF acceptance cannot be a predicate for NUSF eligibility and present further information regarding the proper allocation of support that is associated with the carriers' on-going costs of provisioning service in Nebraska.

II. <u>Objecting Commentors' Misunderstanding of CAF II</u>

The Objecting Commentors misunderstand how CAF II works; therefore their view of how NUSF support can and should interact with CAF II support is erroneous and their recommendations must be rejected. The FCC did not intend for CAF II to replace the need for state universal service programs. To the contrary, the FCC recognized that the Federal program is limited by its budget and design and "welcome[ed] and encourage[ed]" states to supplement federal funding to ensure that the shared Federal and state universal service goals continue to be achieved. Further, the FCC's cost model does not assure cost recovery, as it is forward-looking in nature. The eligible areas the model identifies are in pockets and not laid out consistently with how an efficient network would be designed and built. Moreover, the PC Carriers will continue to have COLR obligations in areas not receiving CAF II support and those areas will require NUSF support. CAF II was not intended to replace state universal service support. The NUSF program should continue to work together with the federal USF to ensure that rural Nebraskans have access to telecommunications and advanced services at rates that are reasonably comparable to those services provided in urban areas as the PC Carriers have recommended.

The first thing on which this Commission must be clear is that the FCC did not intend CAF II to replace state USF funding. Indeed, had the FCC so intended, it could have readily said so, but there is no language in the *CAF Order* suggesting that to be the case. Rather, the opposite is true. The FCC acknowledged that CAF II funding is insufficient to reach all eligible locations:

> We thus are not persuaded to increase high-cost universal service support further. Instead, we advance our broadband universal service goals through the high-cost fund to the extent we are able within the existing budget. We also note that the states have an important role to play in advancing universal service goals. We welcome and encourage states to supplement our federal funding, whether through state universal service funds or other mechanisms.[2] (footnotes omitted)

Initial Comments of Rural Independent Companies, pages 4 – 5 (suggesting that CAF support covers the entire cost of services).

[2] December 18, 2014 Report and Order, para. 28

Thus, the FCC itself, in setting forth the final parameters of the CAF II program, encouraged states to develop programs to supplement CAF II funding. The FCC knew that a funding gap remains, one which it asked the states to fill. The FCC so urged the states because the FCC clearly understood that its cost model is a tool for allocating a budgeted resource, not a total cost recovery mechanism. The PC Carriers urge this Commission to accept these facts in this proceeding.

The CAF II support that the PC Carriers will receive via the FCC's state-wide offer, if elected, is to be used for the deployment and operation of broadband service at a minimum speed of 10 Mbps downstream and 1 Mbps upstream to the FCC determined eligible locations. The FCC's forward-looking cost model assumes broadband deployment in an abstract, perfect world, one that does not match up with the reality of designing and building a broadband network to large rural swaths of Nebraska and the rest of America.

As with any forward-looking approach to cost, there will necessarily be gaps between projected and actual costs. Further, the real world design and building of a broadband network is not done to serve only discrete pockets (census blocks) receiving CAF support within a larger network overlay. The census blocks targeted for CAF II funding by the FCC model are tightly intermixed with many areas that will receive zero CAF II support, such as the areas that were screened out through the CAF II challenge process, areas which have costs above the extremely high cost threshold, and areas that may not have adequate broadband but the model determined the cost was below the funding benchmark.[3] An eligible area was defined as a census block where there was no competitor and the cost to deploy broadband based on the forward-looking model fell between a floor and an extremely high cost ceiling. These floor and ceiling triggers were derived to fit the budget established by the FCC and are not indicative of whether it is economic to deploy the required broadband speed in any given area absent support. Thus, as noted earlier, because the FCC's CAF II budget was not adequate to support the entire broadband network, the FCC's cost model is merely an allocation tool for distributing a fixed amount of support among the census blocks deemed eligible in the model.

In addition to the above-described limits of model-based support, there are significant obligations that are placed on a price cap company for accepting the CAF II support, including aggressive build out schedules and reporting requirements. In many instances, the amount of CAF II support that a

[3] Although census blocks may have been eliminated from funding through the CAF II challenge process this does not mean that those census blocks have access to the minimum 10/1 megabit speed thresholds required by the FCC, since the challenge process used a 4/1 megabit speed threshold from a competitor as determining whether to withhold funding for the particular census blocks.

price cap company will receive will not cover the costs associated with the deployment and operations for the eligible locations. But, as noted above, CAF II support was not designed and funded that way. The FCC itself, in setting forth the final parameters of the CAF II program, encouraged states to develop programs to supplement the CAF II funding because it knew the limitations of CAF II model-based support. Therefore, use of NUSF funding to help offset the companies' cost associated with deploying broadband service in CAF II eligible areas is consistent with the intent of the NUSF fund and with the FCC's recommendation for state supplemental support. Such supplementation, as the PC Carriers propose in this case, is not "double dipping."

The CAF II state-level election is an enormous decision point with long term ramifications. A large portion of the decision is going to be based on the relationship between the available support, potential revenues, and actual cost to build and operate the network. State support that can be used to help offset these costs will play a significant role in the decision equation. The FCC has also recognized that companies require the flexibility in meeting their buildout obligations in order to accept the state-level offer. Implicit in the decision regarding acceptance are the negative impacts to market share and scale where other carriers may subsequently win competitive bids for CAF II support, and the opportunity costs related to the company's investments in these markets over others. Therefore, the decision to accept state-level CAF II funding is not simple, but one that has many facets. The assumption that acceptance will only be made where the FCC's CAF II support offer offsets costs or where CAF II exceeds the current frozen USF is simply incorrect.

III. <u>The State-Wide CAF II Offer and NUSF Eligibility</u>

If the CAF II state-wide offer for support is not accepted, NUSF support is still needed to offset the high cost of providing voice service in rural areas of the state. The obligation to provide voice service does not go away with the CAF II program implementation and should continue to be supported by the NUSF. Moreover, the PC Carriers remind the Commission that the support amounts calculated by the Commission's own Support Allocation Model only provides support for the out-of-town, highest cost and lowest density portions of the price cap carriers' service area. These areas are most likely aligned with the extremely high cost census blocks that will receive no CAF II funding, even though the voice obligation in these areas continues. In addition, declining the CAF II state-wide offer does not mean that the price cap company will not ultimately be the CAF II carrier in a particular location. It merely means that the FCC will move to competitive bidding. All ETCs will be eligible to compete for the areas in the competitive bidding process. Should the Commission decide to eliminate NUSF support for a price cap company that elects not to take the CAF II state-wide offer support in Nebraska, the PC Carriers recommend that a) NUSF support continue until the completion of the FCC's competitive bidding process; b) the Commission determine at that point how to redistribute the NUSF support; and c) if the Commission removes NUSF support, that it also must eliminate any remaining public interest obligations that do not apply to all competitive carriers including, but not limited to, carrier of last resort obligations, service quality requirements, and any remaining pricing constraints.

The implementation of CAF II substantially changes the historic paradigm under which universal service support is provided. Historically, both federal and state support were used to offset the cost of providing voice service in high cost areas. Under CAF II, funding is provided in return for a commitment from the price cap carrier that it will deploy and provide broadband service to a specific number of locations in the state. Recipients of NUSF and federal high cost support have not in the past been constrained to use the support in mutually exclusive areas, and such an exclusionary rule should not be applied now. CAF II does not change the public interest objectives of the NUSF to provide communications services to rural high cost subscribers at reasonably comparable rates and service levels to those provided to urban subscribers, nor does CAF II preclude the Commission from using the state funds to improve the availability of high speed broadband service into rural areas of the state.

IV. The Allocation Between NUSF Voice and Broadband Support Going-Forward

The Commission proposed that 50% of each price cap company's frozen support would be used for the ongoing costs of provisioning service, while the remaining 50% would be targeted to broadband deployment and operations.[4] The Commission also stated that it would allow companies to make a showing for an alternative allocation. The PC Carriers believe that a default 50% allocation of NUSF high cost support for the ongoing costs of provisioning service is too low for a number of reasons. First, there is ample evidence that the existing NUSF support, which is used exclusively to offset the high cost of providing service in rural areas of the state, is insufficient to cover the need. The Commission's Support Allocation Model clearly shows that the amount of funding received by carriers only recovers part of the cost of providing service.[5] Cutting that support in half will jeopardize the adequacy of universal service in the state. In addition, the CACM model used by the FCC in developing the CAF II costs show that 71% of the total costs relate to ongoing operational expenses.

[4] June 16, 2015 Order Seeking Further Comment and Setting Hearing, page 6.

[5] According the Commission's Year 11 NUSF Distribution data, the Model calculates that $44.7 million of support is needed, yet only $37.3 million is distributed.

Second, the price cap companies' resources will be taxed to meet the aggressive deployment schedule required for the CAF II funding and it will be extremely difficult to undertake additional broadband deployment projects to utilize all of the NUSF funding allocated to broadband.

For these reasons, the PC Carriers recommend the Commission adopt an allocation of 75% for the ongoing costs of provisioning service and 25% for broadband deployment and operations as a safe harbor allocation of NUSF support. A 75% allocation of NUSF support to offset ongoing costs of providing service in high-cost rural areas is more appropriate since it is very close to the 71% of total costs that relate to operational expenses as determined by the CACM model.[6] A price cap company should be allowed to make a showing to the Commission that its allocation should be different.

Finally, the Commission did not address the issue of how and when the distributions from the fund for broadband deployment would be made. The PC Carriers note that CAF II funding will be provided on an annual basis and companies are not required to provide documentation to the FCC of the costs incurred prior to receiving the funding. The PC Carriers recommend the Commission adopt the same methodology for the broadband portion of the NUSF.

V. Conclusion

The model-generated state-wide offer of CAF Phase II support was neither designed nor intended as a way for price cap carriers to recover all of the costs for deploying and operating broadband networks to serve CAF II eligible locations. Nor was CAF II designed or intended to take the place of state-provided USF support. State supplementation of the federal program is necessary, and the approach the PC Carriers recommend for coordinating CAF and NUSF support should be adopted.

[6] The PC Carriers reviewed the information that is available in the CACM file: SS20150428CAM43_CBGDetail_Node4WorkingCust ,which details the components of the Total Cost determined by the CACM model. This file presents the Monthly Costs at the census block group level for the following expense components that are part of the Total Cost: Plant Specific, Plant Non-Specific, Customer Operations, General Administrative, Bad Debt, Depreciation. and Tax. These data are reflected in columns L through Q respectfully of this file. Column R represents the Tax (taxes related to the return) and Column S represents the Cost of Money components of Total Cost. Column T reflects the Total Cost which is the sum of the expense related items plus the tax and cost of money. For the three PC Carriers using the Nebraska specific files the sum of columns L though Q, which reflect the on-going expense related components of Total Cost, divided by Column T (Total Cost) reflects 71% of the CACM Total Cost is associated with the on-going expenses.

Dated July 14, 2015

Respectfully submitted on behalf of

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 14th day of July, 2015, a true and correct copy of the foregoing was delivered via email and hand-delivery to the following:

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