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September 25, 2009

VIA HAND DELIVERY

Honorable Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

RE: In Re: Docket to Study Merits of Rural Affordability Fund, TRA Docket No. 09-00096

Dear Chairman Kyle:

Enclosed please find the original and thirteen (13) copies of *Verizon's Response to the Authority's September 4, 2009 Data Request Regarding the Merits of a State Rural Affordability Fund* in the above-captioned docket. Verizon appreciates the opportunity to submit this response.

Respectfully submitted,

Melvin J. Malone

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Enclosures

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BEFORE THE
TENNESSEE REGULATORY AUTHORITY

Nashville, Tennessee

DOCKET TO STUDY MERITS OF RURAL AFFORDABILITY FUND	)	DOCKET NO. 09-00096

VERIZON'S RESPONSE TO THE AUTHORITY'S SEPTEMBER 4, 2009 DATA REQUEST REGARDING THE MERITS OF A STATE RURAL AFFORDABILITY FUND

MCImetro Access Transmission Services LLC d/b/a Verizon Access Transmission Services, TTI National, Inc., Teleconnect Long Distance Systems & Services Company, MCI Communications Services, Inc. d/b/a Verizon Business Services, Verizon Long Distance LLC, Verizon Enterprise Solutions LLC, Verizon Select Services Inc., and Verizon Wireless (collectively, "Verizon") hereby respectfully submit their response to the September 4, 2009 Data Request from the Hon. Darlene Standley, Chief – Tennessee Regulatory Authority's Utilities Division, requesting comments regarding House Bill 2117/Senate Bill 2147, and the potential implementation of a Tennessee Rural Affordability Fund. As discussed below, Verizon supports more uniform switched access rates, but opposes both the creation of any state universal service fund, in general, and the specific manner in which the proposed legislation would do so. Competition already has achieved the goals the proposed legislation purports to target – providing rural and urban consumers alike with access to quality telephone and broadband services throughout the state from a number of competing providers at affordable rates. A state universal service fund therefore is not needed in Tennessee.

I. BACKGROUND AND OVERVIEW

During the most recent legislative session, the Utilities & Banking Subcommittee of the House Commerce Committee considered legislation that would require incumbent local exchange carriers ("ILECs") with less than one million access lines to reduce their intrastate switched access rates to the level of their interstate switched access rates, just as the Regional Bell Operating Company ("RBOC") for Tennessee – BellSouth (d/b/a/ AT&T) – has done. Indeed, there is no reason to allow local exchange carriers to continue recovering a disproportionate share of their revenues from their competitors through unreasonably high access charges. These local exchange carriers divert millions of dollars each year from other carriers to subsidize their own operations, without being required to submit to any meaningful examination or to justify these unreasonable rates. Many of these carriers charge intrastate switched access rates that are many multiples higher – *15 or more times* greater – than BellSouth's switched access rates (as well as the rates of a number of competitive local exchange carriers). There is no justification for this enormous disparity in prices for the same service.

Mid-sized and smaller carriers' excessive intrastate access rates force unwilling subsidies from competing carriers, which have no choice but to pay those rates when they must originate and terminate traffic to customers of these carriers. Perpetuating this irrational rate structure in today's competitive environment is fundamentally anti-consumer and inconsistent with the pro-competitive principles of the 1996 Act. This rate structure causes access purchasers to divert revenue to support other carriers' operations, and denies their own customers the benefits of cost savings that otherwise might be passed along in the form of improved products, services, or networks, or even lower rates. Meanwhile, consumers in the territory of carriers with excessive access rates also suffer, as their opportunities for competitive alternatives are diminished because prospective alternative service providers have to compete with heavily subsidized LEC operations and as a result, either may choose not to compete in those areas or may not compete as effectively.

As the Federal Communications Commission ("FCC") has observed, economically efficient competition and the consumer benefits it yields cannot be achieved as long as carriers seek to recover a disproportionate share of their costs from other carriers, rather than from their own end users.[1] The FCC emphasized that such irrational access rate structures "lead to inefficient and undesirable economic behavior." *CALLS Order*, ¶ 129. With regard to relatively small, rural carriers, in particular, the FCC found that rationalizing their switched access rates will enhance incentives for interexchange carriers to originate service in rural areas and will foster facilities-based competition for residential subscribers in those areas. *MAG Order*, ¶ 11.

In taking the next step to move toward a more uniform Tennessee switched access rate level by reducing the excessive access rates of mid-tier and smaller carriers, the Tennessee Legislature will be in good company. For example, last year, the Iowa Utilities Board, in accordance with legislation directing the Board to remove subsidies in ILEC price structures (Iowa Code § 476.95(3)), significantly reduced the access rates of rural carriers,[2] and is now

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[1] *See generally Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*"); *Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report & Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613 (2001) ("*MAG Order*").

[2] *In re: Iowa Telecomm. Ass'n*, Final Order, Docket Nos. TF-07-125 & TF-07-139 (Iowa Util. Bd. May 30, 2008).

investigating the access rates of Iowa Telecom, the second-largest carrier in the state.[3] The Virginia Commission, having reduced Verizon's ILEC affiliate's access charges in 2004, recently issued an order requiring Embarq to substantially reduce its switched access rates[4] – after the Hearing Examiner concluded that subsidies provided through excessive rural LEC access rates are "no longer sustainable in the competitive market" and that those subsidies "continue to limit or dampen competition in opposition to the pro-competitive policies embodied in" Virginia law.[5] The Kansas Commission decided to proceed on a complaint addressing Embarq's unreasonably high access rates because a "level playing field" is important "to the growth of competition."[6] And, after the Washington Commission Staff recommended access reductions for Embarq, a settlement was reached by the parties in that case.[7]

These other states make for good comparisons to Tennessee. As here, the access rates of the Regional Bell Operating Companies in those states have been reduced, but the smaller carriers have resisted comparable restructuring. To promote competition and consumer welfare, the Tennessee Regulatory Authority ("Authority" or "TRA") should recommend that the Tennessee Legislature reduce the unreasonably high access rates of the remaining carriers.

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[3] *In re: MCIMetro Access Transmission Services LLC, d/b/a Verizon Access Transmission Services, and MCI Communications Services, Inc., d/b/a Verizon Business Services v. Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom; Iowa Telecom North; Iowa Telecom Systems; Iowa Telecom Communications, Inc.; IT Communications LLC, and Frontier Communications of Iowa Inc.*, Docket No. FCU-08-6 (filed Feb. 20, 2008).

[4] *See Petition of Sprint Nextel For Reductions in the Intrastate Carrier Access Rates of Central Telephone Company of Virginia and United Telephone-Southeast, Inc.*, Case No. PUC-2007-00108, Order on Intrastate Access Charges (Va. State Corp. Comm'n, May 29, 2009).

[5] *Id.* at 25, 27.

[6] *See Petition of Sprint Communications Company et al. to conduct general investigation into the intrastate access charges of United Telephone Company of Kansas et al.*, Docket No. 08-GIMT-1023-GIT (Kansas Corp. Comm'n, Oct. 10, 2008). A decision is pending.

[7] *See generally* Testimony of G. Blackmon in *Verizon Select Services, Inc., et al v. United Tel. Co. of the Northwest*, Wash. U.T.C. Docket UT-081393 (filed June 5, 2009).

What the Authority should ***not*** do is recommend creation of a new universal service fund for these carriers to recover lost access charge revenues. As drafted, the proposed legislation – House Bill 2117/Senate Bill 2147 ("TRAF Bill") – contemplates creating a new state universal funding mechanism, purportedly aimed at promoting broadband deployment, "preserving universal service and maintaining carrier of last resort obligations in rural areas of Tennessee." TRAF Bill § 1(b). Among other things, the bill would provide explicit subsidies to certain Tennessee ILECs that operate in rural areas – paid for by contributions from other providers (in many cases, the ILECs' competitors) and then recovered through a new surcharge levied on consumers. *Id.* at § 1(h) ("contributing providers may pass on a surcharge to their end user customers to recover the TRAF charge ..."). In other words, competing carriers would *still* be subsidizing the ILECs, but the subsidy vehicle would be shifted from access charges to direct contributions to a fund – but without any review of these carriers' earnings or any analysis of how the carriers are actually using the money funneled from their competitors.

Even worse, the draft bill would require wireless carriers and voice-over-Internet Protocol ("VoIP") providers to subsidize the ILECs, thereby taxing the very technologies that are helping to bring affordable local telephone service to Tennessee consumers across the state, including rural areas. This approach – unnecessarily hobbling some competitors in favor of others – would be directly contrary to and, indeed, undermine Tennessee legislative policy "to foster the development of an efficient, technologically advanced, statewide system of telecommunications services[.]" Tenn. Code Ann. § 65-4-123.

The Authority should strongly advise the Legislature that while access reductions are necessary, a state universal service fund is not. This advice would advance the Authority's efforts, over the last several years, to help transition the retail telecommunications market from state-sanctioned monopolies to market-driven competition. This oversight has produced a vibrant, competitive market for telecommunications services throughout Tennessee, driven by consumers' increasing demand for choice and innovation. This demand has led to tremendous growth in competition for wireline services, as well as the rise of intermodal competitors that provide telephone voice services, including wireless, cable and VoIP providers.

For example, the Authority's 2007-08 Annual Report notes that, as of June 30, 2008, "Tennessee had three hundred and twenty nine (329) companies providing local telecommunications services in Tennessee including 27 incumbent providers (18 investor-owned and 9 telephone cooperatives), 177 competitive local exchange carriers ("CLECs") and 185 resellers of local telephone services." *Annual Report of the Tennessee Regulatory Authority for Fiscal Year 2007-2008* ("TRA Annual Report") at 35.[8] Not surprisingly, given the sheer number of available providers, 93% of Tennessee households had wireline telephone service as of March 2008. *Id.* By June 2008, the FCC determined that there were at least 2,958,413 total wireline access lines in Tennessee.[9]

As significant as those numbers are, they are only one part of a landscape that also features a large number of intermodal subscribers, including wireless and VoIP customers. Moreover, by June 2008, the FCC had determined that there were nearly as many "high-speed"

[8] The TRA Annual Report is available on-line at http://state.tn.us/tra/reports/anlrpt08.pdf.

[9] *Local Telephone Competition: Status as of June 30, 2008*, Industry Analysis and Technology Division, Wireline Competition Bureau (July 2009) ("*FCC Local Competition Report*") (Table 7) (identifying total number of end-user switched access lines served by reporting local exchange carriers). The *FCC Local Competition Report* is available at www.fcc.gov/wcb/stats. An additional number of switched access lines were served by non-reporting local exchange carriers. However, most or all of those non-reporting carriers appear to have been CLECs (*see* Table 13), which serve a smaller number of customers in Tennessee than do ILECs.

internet access lines in Tennessee (2,767,503) as reported landline access lines (2,958,413).[10] The FCC's report merely reflects the latest available figures for the rapidly expanding broadband market in Tennessee and, given the trends in the data, likely underestimates the number of high-speed internet access lines available today. As of June 2003, there were only 413,476 high-speed internet access lines in Tennessee.[11] The number has increased every year since – in some cases, significantly. The number of high-speed access lines in Tennessee passed 1,000,000 by June 2006 and 2,000,000 just one year later.[12] Accordingly, while the 2,767,503 high-speed lines reported for June 2008 represented another substantial increase, the current number of high-speed lines likely is even higher.

As a result of this dramatic increase in high-speed access lines, the vast majority of Tennessee residents now have access to high-speed internet services from multiple providers. As of June 30, 2008, xDSL was available for 83% of all residential end-user premises in Tennessee for which ILECs offer local telephone service.[13] High-speed cable modem service was available for 96% of residential end-user premises in Tennessee where cable systems offer cable television service.[14] (Both figures were exactly on par with the national average.) As of that date, every single zip code in Tennessee had at least two different high-speed internet providers.[15] More than 90% of all Tennessee zip codes enjoyed at least five different high-speed providers.[16] More

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[10] *High-Speed Services for Internet Access: Status as of June 30, 2008*, Industry Analysis and Technology Division, Wireline Competition Bureau (July 2009) ("*FCC High-Speed Internet Access Report*") (Table 9). The FCC High-Speed Internet Access Report is available at www.fcc.gov/wcb/stats.

[11] *FCC High-Speed Internet Access Report* (Table 10).

[12] *Id.*

[13] *Id.* (Table 14).

[14] *Id.*

[15] *Id.* (Table 17).

[16] *Id.*

than half of all Tennessee zip codes featured at least eight different high-speed providers and 35% had at least ten high-speed providers serving that zip code (better than the national average).[17] And, impressive as these numbers are, they are significantly understated. In addition to the fact that all these numbers likely have only increased since last summer, they do not take into account wireless broadband services.

As the above data makes clear, the proliferation in landline and intermodal competition has meant that consumers in both rural and urban areas of Tennessee ***already*** have access to quality services from a number of competing providers at affordable rates – which is precisely the objective of the contemplated fund. Since the goals of universal service already have been achieved through competition, any government subsidies at this point are unnecessary. Indeed, in these circumstances, establishing the contemplated TRAF not only would be inconsistent with the competitive marketplace fostered by the Authority, but would burden consumers with additional – and unnecessary – surcharges.

Below, Verizon provides its responses to the fourteen items the Authority identified in its September 4, 2009 request for comments.

II. VERIZON'S RESPONSES TO THE SPECIFIC ITEMS SET FORTH IN THE AUTHORITY'S SEPTEMBER 4, 2009 DATA REQUEST.

Against the backdrop of Verizon's opposition to the establishment of any state universal service fund, in general, Verizon hereby provides its responses to the fourteen specific items outlined in the Authority's September 4, 2009, Data Request regarding the potential establishment of the TRAF. Certain of those fourteen items presume that the TRAF (or a similar fund) has been or should be established. While Verizon maintains that neither the TRAF nor any other such fund should be established, Verizon nevertheless has attempted to respond to each of

[17] *Id.*

the fourteen items so as to provide the most complete information possible to the Authority. To be clear, however, by responding to specific items that presume a new state fund should be established, Verizon is in no way endorsing the establishment of any fund.

1. Please discuss in detail the financial impact of reducing your company's access rates to the interstate level as proposed in the legislation.

The proposed legislation contemplates that only "incumbent small local exchange carriers with less than one million (1,000,000) access lines and cooperatives" would be required to reduce their "intrastate (carrier common line and switched access) rates to their billed interstate rate levels ...." TRAF Bill § 1(j). Verizon is not an ILEC or cooperative in Tennessee and, therefore, would not be subject to a rate reduction under the terms of the proposed legislation.

2. Please discuss the merits of the TRAF as proposed and any changes/modifications that you believe would be necessary in establishing this fund.

There is no merit to establishing the TRAF and Verizon opposes creation of the fund. Among other things, the proposed legislation is based on several incorrect assumptions – chief among them that there is any need at all for a state universal service fund to subsidize traditional wireline local telephone service in the current, hyper-competitive intermodal telecommunications environment in Tennessee and that rural local exchange carriers should be entitled to receive government subsidies without any showing of their actual costs or need.

The objective of any universal service fund is to ensure that consumers in all areas have access to basic telephone service at affordable rates. *See, e.g.*, 47 U.S.C. § 254(b). Basic telephone service historically was provided via wireline local exchange service. Because the costs of providing wireline local telephone service in certain rural areas historically tended to be higher than the costs of providing wireline service in more densely populated urban areas, all things otherwise equal, the theory was that rates charged to consumers in those rural areas would tend to be higher. Universal service funds therefore attempted to make service in rural areas more affordable by providing an explicit subsidy to local exchange carriers that offered wireline service to rural areas. By defraying a portion of the costs of providing wireline service in rural areas, the fund allowed rural local exchange carriers to charge lower rates.

Subsequently, the rise of competition, technological innovations, and the proliferation of intermodal providers have dramatically altered the landscape. These changes have driven down the costs associated with providing basic telecommunications services in rural areas. (For example, wireless providers often can provide service in rural areas at lower costs than can traditional wireline carriers, and even wireline providers can use new technology to reach rural areas more efficiently and cost-effectively.) The result has been greater choice and lower rates for consumers.

Unfortunately, however, the TRAF Bill does not recognize these changes and simply assumes that all of the historic conditions that originally generated the desire for universal service funding still exist today. In particular, the TRAF Bill clings to the assumptions that: (a) universal service means access to a traditional landline (because wireline local exchange service is the only service it proposes to subsidize); (b) the costs of providing telecommunications service to rural areas remain prohibitively high (so it does not require any rural local exchange carrier to demonstrate that it *actually* faces high costs); and (c) without a new, explicit subsidy to certain rural carriers, consumers in rural areas cannot obtain access to basic telephone service at affordable rates. *See*, *e.g.*, TRAF Bill § 1(b) ("[t]he TRAF is critically important to preserving universal service and maintaining carrier of last resort obligations in rural areas of Tennessee."). None of these assumptions is correct in today's market.

To the contrary, as the data cited in Section I, above, makes clear:

- ***Universal service no longer just means access to a traditional landline.*** With the rise of intermodal providers, consumers no longer rely exclusively upon traditional wirelines for their basic telephone service. An increasing number of Tennessee consumers use intermodal services, such as wireless and VoIP, for basic telephone service, in many cases entirely replacing traditional wireline phones with these intermodal technologies. As such, it is an entirely outdated mindset to think that the government should be subsidizing one form of basic telephone service (*i.e.*, traditional wireline local exchange service) when consumers already have access to – and increasingly prefer – other forms of service (*e.g.*, wireless telephone service and VoIP).
- ***The costs of providing service to rural areas are <u>not</u> prohibitively high.*** Multiple providers already are serving rural areas throughout Tennessee. As the Authority has reported, there are more than 300 companies already providing wireline local telecommunications services throughout Tennessee – reaching 93% of Tennessee households[18] – and numerous CLECs have access charges that are lower (sometimes substantially lower) than the ILECs' access charges. These penetration numbers do not even account for the numerous wireless and VoIP providers that provide service to subscribers throughout the state – many of whom exclusively utilize these intermodal technologies in lieu of wireline local service. As of June 2008, every single zip code in Tennessee was served by at least two different high-speed internet providers, more than 90% had at least five different high-speed providers, and 35% had at least ten high-speed providers (better than the national

[18] *TRA Annual Report* at 35.

average).[19] As these numbers make plain, there is no shortage of telecommunications providers throughout Tennessee – belying any notion that the costs of providing service prevent providers from serving rural areas in the state.[20]

- ***A government subsidy is not necessary to ensure that consumers in rural areas have access to basic telephone service at affordable rates.*** Consumers throughout Tennessee already have access to basic telephone service at affordable rates. Every zip code in Tennessee already has access to wireline, wireless and/or high-speed internet service from multiple providers. Competition among these providers ensures that rates for basic service remain affordable – a fact born out by the penetration statistics cited above.

Robust wireline and intermodal competition throughout Tennessee has created affordable alternatives to basic local exchange telephone service. As a result, the assumptions underlying the TRAF Bill are incorrect and the rationale for subsidizing traditional wireline local telephone service is no longer valid. When consumers have access to quality services that are being provided by a number of competing carriers at affordable rates, the goals of universal service are achieved and government subsidies are unnecessary.[21]

Moreover, the manner in which the TRAF Bill proposes to fund universal service is based on several assumptions regarding access charges that are highly problematic. The legislation appears to presume that rural local exchange carriers are able to provide basic local

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[19] *FCC High-Speed Internet Access Report* (Table 17).

[20] At a minimum, the data casts enough doubt about the actual costs of providing service to rural areas that the TRAF Bill's funding mechanism – which would provide subsidies to rural ILECs on the assumption that they face legitimately higher costs, without any sort of showing of actual need – must be rejected out-of-hand. *See also* Responses to No. 5, 8 and 11, *infra.*

[21] The above-referenced data also confirms that competition already has satisfied the proposed legislation's desire for wide-spread broadband availability. That issue is discussed in the Response to No. 6, below.

telephone service at affordable rates only because that service is being implicitly subsidized with revenues from intrastate switched access services. Recognizing that subsidization of local rates through switched access charges – and unreasonably high switched access charges, in general – carry significant negative public policy consequences, the bill proposes to reduce intrastate switched access rates chargeable by small ILECs. *See* TRAF Bill § 1(j). But, at the same time, the bill would allow rural ILECs to make up the full amount of those reductions through a universal service fund surcharge. *Id.* §§ 1(j)-(k). In other words, the TRAF Bill would replace the (presumed) implicit subsidy – access charges – with an explicit subsidy – the TRAF.

It is unclear, however, whether Tennessee rural local exchange carriers in fact are subsidizing local rates with access revenues. (And, unfortunately, the proposed legislation does not provide for any means of examining whether this is the case.[22]) ***Rural ILECs in Tennessee already receive a substantial amount of federal universal service fund support – tens of millions of dollars a year – to assist in covering allegedly high cost areas.***[23] Thus, it is entirely possible that rural ILECs already are able to recover their local costs through a combination of their current local rates and/or federal USF payments, without significant (or any) subsidization from access charges.

Moreover, because the market does not constrain ILECs' access rates in Tennessee (evidenced by the huge disparity among carriers' rates), it is possible – and, indeed, likely – that many rural ILECs' current intrastate switched access rates bear no relation to any costs at all and instead simply are unreasonably high. While the telecommunications industry today is highly competitive, with constantly evolving technologies and services delivering choice and innovation

[22] *See, e.g.*, TRA Bill §1(n) ("The authority shall not require or conduct a rate case, earnings review or cost analysis in connection with the revenue recovery of the access rate reductions.").

[23] *See* FCC, *Universal Service Monitoring Report*, CC Docket No. 98-202 (Dec. 2008) (prepared for the Federal-State Joint Board on Universal Service in CC Docket No. 96-45).

to consumers, switched access is a notable exception to this overall trend. A long distance carrier has no choice but to use a local exchange carrier's switched access services when it handles interexchange calls originating from the LEC's customers and when it delivers interexchange calls for termination to the LEC's customers. A long distance provider cannot refuse to deliver a call to an LEC's end user – and thus cannot avoid the LEC's terminating access charges, no matter how high or how unreasonable. For this reason, the TRAF Bill may do nothing to promote universal service, but instead may guarantee a windfall profit stream for certain rural incumbent local exchange carriers, to the competitive disadvantage of other carriers.

This concern is only exacerbated by sections (k), (l) and (m) of the proposed legislation, which establish a formula to calculate universal service subsidies based on carriers' 2008 intrastate switched access minutes. In particular, the formula provides that the "initial TRAF amount shall be determined" by multiplying the difference between current (as of December 31, 2009) intrastate and interstate access rates times the number of intrastate access minutes from 2008. TRAF Bill § 1(k). Under this formula, the more intrastate access minutes included in the calculation, the more money goes into the fund. But, since intrastate access minutes are declining, using (higher) 2008 minutes – instead of (lower) 2009 figures – means that the rural ILECs would receive an additional windfall (on top of the windfall they would receive from establishment of a fund in the first instance). Since it would be at least 2010 before any legislation would take effect, the 2008 data would be even more stale by the time the formula would be applied. There is simply no legitimate reason to calculate lost revenues on the basis of anything but current minutes.

In short, the proposed TRAF Bill would implement a fund in such a manner that would skew the competitive market (which already has achieved the goals of making affordable basic service and broadband available to consumers throughout Tennessee), lead to inefficiencies (by, among other things, subsidizing certain carriers without any showing of costs or need), and burden consumers with higher surcharges.

Consumers within the subsidized rural areas also would suffer as their opportunities for competitive alternatives would diminish over time, because any carriers that wished to enter a market where a rural ILEC receives TRAF payments would have to compete with heavily subsidized operations that, under the current draft of the bill, would not have proved any need for such subsidies. As a result, potential competitors may not compete effectively or may choose not to enter a rural market. Those rural customers also might be deprived of service, product and network innovation by the subsidized rural ILEC itself, because a carrier that is guaranteed a constant and risk-free stream of revenue from a source other than its customers, thus helping to ward off competition, naturally will have less incentive or need to develop and deploy innovative products and services to retain and attract customers. Competition, efficiency, and innovation all suffer when a carrier is able to rely on guaranteed revenue streams from other carriers, rather than on revenues from its own end-user customers.

For all these reasons, the proposed TRAF is not in the public interest and should be rejected.

3. What should be the determining factors and criteria in determining whether to establish a TRAF?

The primary consideration in determining whether to establish a TRAF should be whether any such fund is necessary. In answering that question, the Authority should be guided by three basic consumer principles:

(1) Tennessee consumers should have access to basic communications services at affordable rates;

(2) any legislative or regulatory intervention should not disrupt market-based competition; and

(3) any fees imposed on consumers to finance the fund should be minimal and need-based.

As discussed in the Response to Item No. 2, above, the TRAF is not necessary. Competition already has assured that Tennessee consumers have access to basic service at affordable rates.[24] Introducing government subsidies now would only skew the market, favoring certain competitors and disadvantaging others, all for the sake of obtaining a goal that already has been met. There is no need to burden consumers with a TRAF surcharge in these circumstances. No fund should be established.

Moreover, even if some sort of fund were to be established (and it should not be), the Authority should examine whether the proposed legislation would implement the fund in a manner that best achieves the fund's objective while maximizing competition and efficiency. That would require a determination of whether the legislation ensures in some way that TRAF payments are being provided only where rural service is not feasible without those subsidies or, in other words to those carriers that have a true need for funding based on actual costs and affordable rate levels. It also would require a determination that the proposed funding mechanism is the right one, meaning it would require a determination that rural ILECs had been using intrastate access charges to subsidize their local rates, such that those carriers should be entitled to recoup all of the required access charged reductions through USF payments, and that those local rate levels are appropriate.

As discussed in the Response to Item No. 2, the proposed TRAF Bill does not provide any mechanism for making these determinations. To the contrary, the proposed legislation

[24] Competition likewise has assured that Tennessee consumers have access to broadband services. That issue is discussed in the Response to Item No. 6, *infra*.

simply presumes that rural ILECs should receive subsidies without any individual showing of cost or need. Accordingly, the proposed legislation does not provide a mechanism for ensuring that the fund's implementation has any relation to its objectives.

4. Please discuss whether prices and service offerings should be comparable between all rural and urban areas, and how this determination should be made?

There is not and should not be any comparability requirement under state law. While federal law identifies comparability as a criterion for developing federal universal service policies, there is nothing in state law that would so limit the Authority's ability to regulate intrastate rates.

The federal universal service statute lists the governing "principles" that the FCC and the Federal-State Joint Board on Universal Service are to follow. One of these is that "[c]onsumers in all regions of the Nation, including low-income customers and those in rural, insular, and high cost areas, should have access to telecommunications … at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. § 254(b)(3). This provision applies only to the administration of the federal universal service fund; it is not a mandate to state commissions and does not require "reasonable comparability" in the administration of any state universal service fund.

While some states voluntarily have chosen to apply a standard of "reasonable comparability" to urban rates, others have not. And those that have done so have taken widely divergent views of what percentage or margin above urban rates could be considered "reasonably comparable." Accordingly, the Authority should not be constrained by this principle here – particularly where certain urban rates in Tennessee historically have been kept artificially low by regulatory limitations and do not provide a valid point of comparison.

Moreover, if costs were higher in rural areas, it would not make sense for customers in those high-cost areas to pay comparable (or even lower) rates for service if the difference between costs and rates is being made up or paid for by other telecommunications carriers through USF payments. If a rural carrier faces greater costs, it should look to recover those costs from its own end-user customers, rather than from other carriers that – in many cases – are its competitors.

5. Should the earnings of incumbent local exchange companies (ILECs) operating under rate-of-return regulation be examined prior to receiving TRAF funds?

Yes. For rate-of-return carriers, some sort of process that takes into account an ILEC's costs and earnings is essential to determining whether there is a need to subsidize that ILEC through state universal service funds, particularly since Tennessee carriers already receive federal universal service funds expressly intended to subsidize local exchange service. That determination must be made *before* the creation of any state fund.

The proposed legislation currently does not provide any mechanism for examining an ILEC's costs or earnings prior to disbursement of TRAF funds. To the contrary, under the TRAF Bill, rural ILECs would be entitled to subsidies without any showing of cost or need.

To the extent any state fund is established, however, disbursements from that fund should be allowed only after some sort of showing that, without such a subsidy in a service area, basic telephone services would not be available in that area. In other words, disbursements of high-cost support should be targeted only to those areas where no provider otherwise would provide quality services at just, reasonable, and affordable rates.

Targeting the fund in this way would help minimize market disruptions and also would protect Tennessee's consumers, who ultimately will bear the burden of the fund. By limiting funding to only those providers that demonstrate a legitimate need and targeting funding to areas where no other provider exists, the amount of money that must be collected from other carriers and, ultimately, consumers (in the form of end-user surcharges) is also limited. This would minimize the amount that Tennessee consumers would have to pay into the fund, while simultaneously ensuring that the fund is being used solely for its stated purpose of ensuring basic services in high-cost areas.

Demonstration of cost and need, however, does not have to be a difficult or time-consuming process. In its Response to Item No. 8, below, Verizon addresses the manner in which funds could be distributed, including a competitive bidding process in which carriers would have to take their own costs into consideration and thereby eliminate the need for any sort of cost study by the Authority.

6. Should the TRAF target funds for expanding a recipient company's broadband deployment?

No. As discussed above, there is no need to establish the TRAF in the first place, much less expand it to address funding for broadband services. It would be inappropriate (as well as unprecedented) to establish a state universal service to further broadband services, for several reasons.

First, broadband is a competitive service provided over multiple technological platforms and therefore regulation is not needed to encourage its deployment. Moreover, regulation in the form of subsidies can negatively affect the deployment of broadband services by competitive carriers. As noted above, there already are multiple providers selling high-speed services in every zip code throughout the state, and there has been substantial growth in the customer subscription rate reported in recent FCC filings. Indeed, Connected Tennessee, an independent non-profit organization dedicated to promoting broadband deployment in the state, reports that home broadband adoption has grown by 26% in Tennessee since July 2007, compared to an estimated national growth of just 15%.[25] Rural areas of the state saw a 30% increase in broadband adoption in 2008, and Tennessee's low-income families with children experienced an explosive 124% increase in broadband adoption last year.[26]

All of this growth has been achieved without subsidies from state universal service funds, which attests to the fact that market conditions are successfully encouraging broadband development in the state. Subsidizing broadband therefore would be a solution in search of a problem. Allowing competitors to continue to deploy facilities and offer services in the competitive marketplace would do more to enhance economic development than artificially subsidized offerings.

Second, establishing universal service support for broadband would significantly increase the size of any contemplated universal service fund, which ultimately would be paid for by Tennessee consumers. It is unnecessary for consumers to bear this burden when market forces already are working effectively.

Third, even if market forces were not successfully encouraging broadband development (and they are), there are other sources of funding available to subsidize broadband deployment, such that creation of a new state fund is unnecessary. The American Recovery and Reinvestment Act ("ARRA" or "Recovery Act") provides funding for two national broadband service development and expansion programs: (1) the Rural Utilities Service ("RUS") program (sometimes referred to as the Broadband Initiatives Program ("BIP")), which provides loans and grants for broadband projects focused on rural areas; and (2) the Broadband Technology

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[25] This report, "Tennessee's Technology's Trends 2009" is available at http://www.connectedtennessee.com, under "Research."

[26] "Connected Tennessee Stimulates Broadband Growth Among Tennessee's Underserved Areas: Connected Tennessee's Focus Areas Exceed National Average in Computer Ownership, Internet Adoption and Broadband Adoption, Press Release, Dec. 18, 2008, available at http://www.connectedtennessee.com, under "Press."

Opportunities Program ("BTOP"), a broader broadband stimulus program to be administered by the National Telecommunications and Information Administration ("NTIA") that targets unserved and underserved areas. *See* ARRA § 6001(b). Various Tennessee providers already have applied for over $250 million in broadband funding under the ARRA. *See* http://broadbandusa.gov (identifying applicants). A number of these applicants are wireless providers, demonstrating that various intermodal providers are capable of providing broadband services and emphasizing the point, discussed above, that there is no justification for the TRAF Bill's exclusive focus on subsidizing wireline local exchange carriers.

Fourth, broadband funding does little if anything to address issues such as broadband adoption, lack of access to computer hardware, and lack of computer literacy. A better approach to these problems is the creation of public-private partnerships such as Connected Nation and One Economy, which have a proven track record for significantly enhancing broadband availability and adoption without government subsidies. For example, the Kentucky model for broadband and technology expansion has been recognized repeatedly as a national leader, and is a program that would be easily transferable to Tennessee as it has been to other states. It could include a grant program to enable the state to develop a comprehensive approach to broadband deployment while simultaneously driving broadband adoption and technology development at a local community level. It could allow non-profit organizations that have established a partnership with state government to apply for funding to:

- Measure and track broadband and information technology use among citizens and businesses, investigate barriers to adoption at a local level and provide market analysis for unserved areas;
- Develop local technology planning teams with members representing a cross section of the community;
- Equip and facilitate local technology planning teams with the tools and resources to improve technology use within each sector; and

- Establish effective programs to improve computer use and Internet access for disenfranchised populations.

Under these circumstances, there is no need to take an already unnecessary state universal service fund and expand it to cover broadband services.

7. Should the TRAF be expanded to replace other sources of implicit funding used to support universal service?

No. Verizon is unaware of any other claims of potential sources of implicit funding beyond (possibly) access charges, which are discussed in the Response to Item No. 2, above. Verizon opposes the establishment of the TRAF, period, and likewise opposes any attempt to establish an even further expanded state fund.

8. Should TRAF disbursements be portable to Eligible Telecommunications Carriers ("ETCs") for customers they serve in these rural areas?

No state universal service fund is necessary in Tennessee. Therefore, there is no need to determine whether fund disbursements should be portable to ETCs. However, if the TRAF were to be implemented (and it should not be), certain guidelines should govern what carriers in what areas are eligible to receive state funds.

As a general proposition, funds should be available only to carriers that demonstrate both high costs and a need for subsidization. The funds should be used only for subsidization of basic local service in high cost areas. And the number of carriers with access to funds should be limited, in order to keep the amount of the fund – and the amounts consumers ultimately must contribute – to a minimum.

With these guidelines in mind, permitting TRAF disbursements to be portable is potentially problematic. Portability could create difficulties in administration. When portable, funds tend to become more difficult to track and in many cases result in multiple providers receiving support for the same household. This typically leads to significant growth in the overall size of the fund, increasing the burden on consumers to finance the fund.

If a state fund were to be established, the better approach would be to limit the availability of state universal service funds to one carrier per geographic region, with a competitive bidding process used to select the subsidized carrier in each region where two or more carriers are seeking subsidization. Other competing carriers would still be free to offer service in that region, but only one carrier would be subsidized for accepting the obligation to provide service at affordable rates. After all, if one carrier already is providing consumers with access to service at affordable rates, there is no need to subsidize other carriers to do so.[27] Limiting disbursements in this manner would help ease the administration of the fund and would minimize the amounts that other carriers, and ultimately Tennessee consumers, would have to contribute.

9. Should the TRA establish a state-wide local residential benchmark rate for universal service and determine necessary universal funding based upon the benchmark, i.e., a company could draw money out of a universal fund if its rates are below the benchmark?

No. If anything, a company should draw money out of a universal service fund only if its rates otherwise are *above* a competitive or affordable benchmark.

To be clear, Verizon opposes the establishment of the proposed TRAF or any other state universal service fund. But, if any such fund is established (and it should not be), the Authority at least should take steps to ensure that rural local exchange carriers are *not* using the fund to maintain local rates below an affordable benchmark in order to gain a competitive advantage.

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[27] Where one provider already is providing service to a particular geographic area, another provider that is not required to provide service in an area should make the decision to enter that area on the basis of its potential costs and earnings, not based on regulatory handouts.

As discussed in the Response to Item No. 2 above, universal service funds historically have been used to subsidize wireline carriers in purportedly high cost areas where, because of those high costs, local rates might be set above affordable levels. The subsidy was intended to help defray the high costs, allowing carriers to charge more affordable rates. If a carrier already is charging a rate that is *below* an affordable or competitive benchmark, however, then that company does not need universal service funding. Whether that company actually has lower costs or has elected to set rates below cost for competitive reasons, its rates already are at an affordable level, obviating the need for any further support. And if a company's rates were set below the affordability benchmark through Authority action, the carrier should be permitted to raise its rates to the benchmark.

Contrary to the draft bill, local exchange carriers traditionally have to have local rates at or *above* the benchmark before becoming eligible for funding. The opposite approach embodied in the draft legislation has not, to Verizon's knowledge, been used anywhere. Otherwise, carriers will exploit the universal service fund to gain a competitive advantage – using a subsidy paid for by other carriers, and ultimately by consumers beyond just its own customers, to maintain rates below competitive market levels in order to attract customers and keep out competing providers, even if they are more efficient. In that case, the universal service fund would not promote universal service, but instead would provide a windfall to ILEC recipients.

10. Please provide your thoughts/suggestions on whether there should be a phase out or reduction in the amount of TRAF funding once carriers elect Market Regulation.

As discussed above, no fund should be established in the first place. However, if the TRAF were to be created, it should not be a permanent fund. Any fund should be implemented only on a short-term basis, and should be phased out as markets continue to become more competitive. Such a phase-out should take, at most, three years. If and when any carrier receiving TRAF funding elects Market Regulation, however, the phase-out should be immediate. Once a carrier has retail pricing flexibility, it has no credible argument that it should receive funding. Such carriers have the ability to change their rates and recover their costs from their own end-user customers without Authority approval and should do so, rather than continue to receive subsidization from their competitors, and consumers beyond their own customer base, through universal service funds. Subsidization of competitors is simply incompatible with competitive markets.

11. What factors and procedures should be considered in determining the per line support amount for rural carriers?

No state universal service fund is necessary in Tennessee. Therefore, there is no need to establish a methodology for determining the per line support amount for rural carriers.

However, if the TRAF were to be implemented (and it should not be), it would be critical to establish a procedure to ensure that no more subsidies than necessary were provided and that each recipient first demonstrated its need for funding in some manner before receipt of funds. *See* Responses to Item Nos. 2-3, 5, *supra*. This approach would mean limiting the fund to one provider per geographic area (*see* Response to Item No. 8, *supra*), and would need to account in some form for individual carriers' costs and earnings and the amount of federal universal service support already received to help defray local costs.[28]

12. Which companies should contribute to the TRAF, and state why or why not?

As discussed above, there is no need at this time to establish the TRAF (or any other state universal service fund). Accordingly, there is no need at this time to determine which companies should contribute to such a fund. However, if the TRAF were to be implemented (and it should

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[28] Indeed, state universal service funding should be provided only to those providers that also qualify for federal universal service funding because that will reduce the amount of state funding needed for that provider.

not be), contributions should be based on a competitively neutral and administratively workable mechanism such as a small charge on working phone numbers.

13. What method should be used to determine the TRAF contribution per company?

As discussed above, there is no need at this time to establish the TRAF or any other state universal service fund. Accordingly, there is no need at this time to determine which companies should contribute to such a fund. However, if the TRAF were to be implemented (and it should not be), contributions should be based on a competitively neutral and administratively workable mechanism, such as a small charge on working phone numbers.

14. If intrastate access rates are reduced in Tennessee, should language be incorporated into the proposed legislation to ensure that companies subscribing to intrastate access do not receive windfall profits, but rather return the access savings to their customers.

No. Such language would be unnecessary because competition in the long distance market would ensure that retail long distance rates include the positive effects of intrastate access cost savings and do not receive "windfall profits."

The Legislature has deregulated the market for retail long distance services in Tennessee, recognizing that it is a fully competitive market that is constrained by competition. In such a fully competitive market, market forces operate to drive rates toward cost, thereby ensuring that consumers receive the benefits of any cost savings, be they in the form of access charge reductions, innovative services, or other benefits. In such a competitive market, long distance carriers that refuse to pass along cost savings simply will lose customers to those carriers that do. Competition therefore polices the long distance market and eliminates any need for the Authority (or Legislature) to do so.

Of course, the cost savings created by reduced intrastate access rates can be passed along in a variety of ways. For example, cost savings may be reflected in reduced long distance rates, or in rates that stay the same because the savings have offset other cost increases, or in a smaller rate increase than otherwise would have been implemented if not for the access savings. Carriers may also use those savings to improve service quality, provide additional features or introduce new service innovations. But, in the competitive long distance market, there is no need to identify precisely how competitors will pass through the benefits of access charge reductions to customers. And there certainly is no need to prescribe or limit the ways in which those savings will flow through. Competition will ensure those benefits will be passed along to consumers in one way or another, obviating the need for any further legislative or regulatory intervention.

III. CONCLUSION

For the foregoing reasons, Verizon opposes the proposed TRAF. In the current competitive environment, no state universal service mechanism is necessary in Tennessee. Verizon appreciates the opportunity to submit this response.

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Respectfully submitted,

By: ______________________

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