Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	WC Docket Nos. 10-90, 07-135 05-337, 03-109
Universal Service – Intercarrier Compensation Transformation Proceeding	)	
	)	CC Docket Nos. 01-92, 96-45
	)	GN Docket No. 09-51

COMMENTS OF

THE FREE STATE FOUNDATION[*]

These comments are submitted in response to the Commission's August 3, 2011 *Further Inquiry* Public Notice soliciting comments on proposals to "comprehensively reform and modernize the universal service fund (USF) and intercarrier compensation (ICC) system in light of recent technological, market, and regulatory changes…."[1] More specifically, after already receiving two rounds of comments in just this latest round of seemingly never-ending proceedings aimed at reforming the universal service and intercarrier compensation regimes, the Commission is now seeking additional comment on the proposals offered by the six Price Cap Companies ("ABC Plan"), the State Members of the Federal State Joint Board ("State Members"), and the Joint Rural Associations ("RLEC Plan").

[*] These comments express the views of Randolph J. May, President of the Free State Foundation. The views expressed do not necessarily represent the views of others associated with the Free State Foundation. The Free State Foundation is a nonpartisan, non-profit free market-oriented think tank.
[1] Public Notice, Further Inquiry into Certain Issues in the Universal Service – Intercarrier Compensation Transformation Proceeding, DA 11-1348, August 3, 2011.

The Commission is to be commended for now showing some sense of urgency for finally tackling USF-ICC reform in a meaningful way. But showing a sense of urging and acting are two different things. Hopefully, the Commission will now act with dispatch.

When the ABC Plan was submitted, I issued a statement to the following effect:

> "The USF reform plan represents a major step forward in the effort to achieve a more efficient, technology-neutral, economically-sound universal service system. Capping the USF fund, directing support only to unserved areas, eliminating subsidy payments to more than one carrier in an area, introducing competitive bidding, and making the remaining subsidies more explicit are all positive market-oriented steps. While I would prefer even more substantial reform with deeper subsidy cuts, it is now up to the Commission, for the benefit of the nation's consumers, to seize the opportunity presented by the plan to quickly accomplish at least this much reform."

In my view, the ABC Plan contains sufficient market-oriented positive elements submission that it should form the basis for the Commission moving forward. But this does not mean that it cannot be improved upon – as long as the changes are further in the direction of eliminating or reducing the existing high-cost subsidy payments more quickly in recognition of the profound marketplace and technological changes that have occurred in recent decades. The Commission must resist the inevitable special pleading designed to protect subsidy recipients at the expense of overall consumer welfare.

In terms of improving on the ABC plan, here are points the Commission should consider for adoption:

1. The Commission should explicitly and immediately impose a hard cap on the high-cost fund at $4.5 billion per year, without any loopholes for overall subsidy increases above that cap. In FSF's recent May 23, 2011 Reply Comments in this proceeding, I emphasized that the Commission's end game "should be the eventual elimination of all high-cost fund and related subsidies," and added, "[p]lacing a hard cap on the high-cost fund and lowering it over time in tandem with a decreasing fund size constitutes a realistic means for achieving that end." Indeed,

subject to ongoing review of conditions at the time, I urged "the establishment of a date-certain deadline, say, approximately ten years, for sunsetting all high-cost and related subsidy programs." Thus, the Commission ought to go beyond the ABC proposal in this regard.

2. One of the positive elements of the ABC plan is that it contemplates ending subsidy support to providers in areas served by an unsubsidized provider. This is a key element for the subsidy system to be viewed as fiscally responsible and competitively neutral. If a provider is receiving subsidy support and an unsubsidized competitor subsequently enters the market, there should be a prompt transition to ending the subsidies. Otherwise, the continuing subsidies are not only wasteful, but they have an anti-competitive impact.

3. With respect to the ABC proposal regarding the incumbent's right-of-first refusal ("ROFR") to receive the subsidy, the Commission should be careful not to tilt the regime in a way that unnecessarily and unfairly favors the incumbent at the expense of new entrants who might be able to provide service on a less costly basis. On the one hand, it may not be unreasonable to recognize an incumbent's sunk investments in a service area, and past history of service, by establishing a basis for the incumbent to exercise some form of right-of-first refusal to receive the subsidy payments for some period of time. On the other hand, it would be inefficient and unfair to award the incumbent an advantage that is too far divorced from the reality that, through a competitive bidding process, service might be provided to the area covered by the right-of-first refusal on a less costly basis. Thus, having in mind these considerations, the Commission should consider adjusting the ABC plan parameters so that the incumbent would be required to have deployed broadband to a greater percentage of locations than the 35% specified. Or the Commission should consider favorably other alternatives suggested in Section I. C. 2. Of

its Public Notice for awarding ROFR support, such as employing competitive bidding if there are at least two providers in the relevant area that exceed a specified threshold.[2]

4. The Commission should set a date for terminating rate-of-return ("ROR") regulation for those carriers that have elected to remain under the ROR regime. Rate of return regulation provides all the wrong economic incentives – incentives that inevitably lead to an inefficient, wasteful allocation of societal resources. In most areas of the country, incumbent wireline telcos are subject increasingly to intense competition from wireless, cable, and satellite operators. Under these circumstances, it is difficult to understand why these providers are subject to ongoing rate regulation at all, much less ROR regulation. In any event, however, at this stage in the development of marketplace competition, it makes sense for the Commission to establish a firm – and not unduly long – transition for ending all ROR regulation. If any rate regulation is deemed necessary, it should be in the form of price cap (incentive-based) regulation.

The Commission should take action consistent with these comments.

Respectfully submitted,

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[2] Public Notice, at 4.