Exhibit No: 8
Issue: Public Interest Policies Supporting ETC Designation; "Redefinition" Of Service Areas
Witness: Don J. Wood
Type Of Exhibit: Surrebuttal Testimony
Sponsoring Party: U.S. Cellular
Case No: To-2005-0384

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

APPLICATION OF USCOC OF GREATER MISSOURI, LLC FOR DESIGNATION AS AN ELIGIBLE TELECOMMUNICATIONS CARRIER PURSUANT TO THE TELECOMMUNICATIONS ACT OF 1996	)	**Case No. to-2005-0384**

SURREBUTTAL TESTIMONY OF DON J. WOOD

ON BEHALF OF USCOC OF GREATER MISSOURI, LLC d/b/a U.S. CELLULAR

October 3, 2005

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d/b/a U.S. CELLULAR

October 3, 2005

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of USCOC of Greater Missouri, LLC for Designation as an Eligible Telecommunications Carrier Pursuant To The Telecommunications Act of 1996	)))))	Case No. TO-2005-0384

AFFIDAVIT OF DON J. WOOD

STATE OF FULTON

COUNTY OF GEORGIA

Don J. Wood, appearing before me, affirms and states:

1. My name is Don J. Wood. I am a principal in the economic and financial consulting firm of Wood & Wood, 30,000 Mill Creek Avenue, Alpharetta, Georgia.

2. Attached hereto and made a part hereof for all purposes is my Surrebutal Testimny on behalf of USCOC of Greater Missouri, LLC d/b/a U.S. Cellular, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby affirm that my answers contained in the attached testimony to the questions propounded, including any attachment thereto, are true and accurate to the best of my knowledge, information and belief.

DON J. WOOD

Subscribed and sworn to before me in the 29th day of September, 2005.

Deborah L Wood
Notary Public

My Commission Expires:

03-27-2009

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Background and Purpose of Testimony

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Don J. Wood. I am a principal in the firm of Wood & Wood, an economic and financial consulting firm. My business address is 30000 Mill Creek Avenue, Suite 395, Alpharetta, Georgia 30022.

Q. ARE YOU THE SAME DON WOOD WHO PREFILED DIRECT TESTIMONY IN THIS PROCEEDING ON JULY 12, 2005?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by USCOC of Greater Missouri, LLC ("USCOC") to respond to the testimonies of Mr. Glenn H. Brown on behalf of Spectra Communications Group, LLC, d/b/a CenturyTel and CenturyTel of Missouri, LLC and Mr. Robert C. Schoonmaker on behalf of The Small Telephone Company Group (together "Rural ILECs").

My testimony is divided into three sections. Section 1 describes the questions that are before the Commission in this proceeding and the applicable requirements that are to be used to answer those questions. Section 2 addresses the question of whether the designation of USCOC as an eligible telecommunications carrier ("ETC") in the areas

served by rural ILECs is in the public interest. Section 3 responds to concerns regarding proposed "redefinition"[1] of the ILEC study areas.

The Specific and Narrow Questions before the Commission

The Standard To Be Applied In This Proceeding

Q. WHAT QUESTIONS ARE BEFORE THE COMMISSION IN THIS PROCEEDING?

A. There are three relevant questions for the rural ILEC areas identified in USCOC's Application: (1) Has USCOC committed to offer and advertise the nine supported services throughout the proposed service area?, (2) Is the designation of USCOC as an ETC in the public interest? and (3) Should the service areas of certain rural ILECs be redefined?

Q. ARE THERE ANY ADDITIONAL QUESTIONS BEFORE THE COMMISSION IN THIS CASE?

A. No. While Mr. Brown and Mr. Schoonmaker may wish otherwise, this proceeding is not an opportunity to second guess Congressional policy as set forth in the 1996 Act or the FCC's interpretation and implementation of that policy as set forth in the federal rules.

[1] As I explained in my prefiled direct testimony, "redefinition" is a misnomer. In reality, no ILEC "study area" is actually being changed. If USCOC's request is granted, the process will be transparent to the ILECs and their operations. The ILECs will not be required to operate in a different manner and their receipt of federal USF support will not change in any way.

It Is Neither Necessary Nor Appropriate To Broaden The Scope Of This Proceeding As Suggested By the Rural ILEC Witnesses

Q. HAVE THE QUESTIONS YOU OUTLINED ABOVE BEEN THE FOCUS OF THE PROCEEDINGS BEFORE OTHER STATE REGULATORS?

A. Yes. As I mentioned in my direct testimony, these questions have been, as they must be, the focus of the review made by the regulators in each case (state regulatory bodies where they had jurisdiction, the FCC where the state regulator did not have jurisdiction). In direct contrast, the rural ILECs have sought to broaden the scope of review and have attempted to put competition on trial. While such attempts have rarely been successful, they have often become distractions that unnecessarily consume the time and resources of all involved. Unfortunately, the rural ILECs in this case have undertaken such a strategy.

Mr. Brown and Mr. Schoonmaker ask the Commission to weigh the benefits and costs of permitting competitive entry into rural areas and the benefits and costs of granting ETC status to more than one carrier in such an area. These questions are not before the Commission in this proceeding. To the contrary, the relevant questions here are specific to USCOC: *Will USCOC offer services that provide benefits to consumers?*, and *Is there some fact or issue that is specific to USCOC, or to the service areas within which it seeks an ETC designation in Missouri, that would outweigh those benefits?* Based on the facts associated with this Application, the Commission should be able to answer "yes" and "no," respectively, to these questions.

As an overarching principle, it is the interests of the public – the consumers of telecommunications services – that must be considered. The interests of individual carriers, or categories of carriers, are a secondary consideration if it is to be considered at all. Both Mr. Brown and Mr. Schoonmaker endorse the idea of "competitive neutrality"

at a conceptual level, but they go on to insist on a series of restrictions and requirements that are anything but competitively neutral.

The FCC and Fifth Circuit Court have been clear that the purpose of the federal universal service mechanism is to protect rural consumers of telecommunications services; its purpose is not to protect incumbent LECs: "The Act does *not* guarantee all local telephone service providers a sufficient return on investment; quite the contrary, it is intended to introduce competition into the market. Competition necessarily brings the risk that some telephone service providers will be unable to compete. The Act only promises universal service, and that is a goal that requires sufficient funding of *customers*, not *providers*. So long as there is sufficient and competitively neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well" (emphasis in original).[2] In stark contrast, Mr. Brown suggests (p. 4) that the Commission should consider the possibility of "significant harm to these companies" – such a consideration is clearly not consistent with long standing FCC policy.

The rural ILECs now seek to re-litigate the FCC's recent decisions regarding the operation of the federal universal service mechanism in rural areas, and are specifically asking the Commission to ignore certain portions – but not others – of the FCC's *Fourteenth Report and Order* and to engage in a process of second guessing both Congress and the FCC regarding (1) the benefits of competitive entry, and (2) the most

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[2] *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000), cited in *Fourteenth Report and Order, Twenty-Second Order on Reconsideration and Further Notice of Proposed Rulemaking in CC Docket No. 96-45*, ¶ 27 (rel. May 23, 2001) ("*Fourteenth Report and Order*").

effective means of ensuring that consumers in rural areas have access to basic telecommunications services at reasonable rates. Setting aside the question of whether the rural ILECs' claims have merit, this is simply not the correct forum for such a debate. I note that although they embrace the FCC's recent order, the inquiry that Mr. Schoonmaker and Mr. Brown seek to undertake is far more broad than the FCC has ever contemplated. The FCC's recent orders granting ETC status to NTELOS and Nextel Partners underscore this observation.

Q. IN HIS TESTIMONY, MR. SCHOONMAKER DESCRIBES THE PURPOSE OF THE FEDERAL UNIVERSAL SERVICE PROGRAM. DO YOU AGREE WITH HIS DESCRIPTION?

A. No; he provides only a partial description that is overly narrow and, as a result, misleading. He asserts (p. 84) that the 1996 Act, including its language regarding universal service, "is not about promoting and advancing competition." There are a number of reasons why it is odd that someone purportedly familiar with the 1996 Act would make such a statement.

First, Mr. Schoonmaker cites (p. 12) the provision in §254(b) that states, as a principle of universal service, that "consumers in all regions of the Nation," "including those in rural, insular, and high-cost areas," should have access to telecommunications services that is "reasonably comparable to those services provided in urban areas." Later in his testimony, he questions the availability of quality wireless coverage in many of the rural areas at issue in this proceeding – service that is certainly available in urban areas. Mr. Schoonmaker does not then explain why the principle of "reasonable comparability" does not apply in this case.

More fundamentally, Mr. Schoonmaker's statement appears to be directly at odds with the first paragraph of the Conference Report of the Act which states Congress' overarching goal:

> To provide for a *pro-competitive*, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of *advanced telecommunications and information technologies* and services to *all* Americans by opening *all* telecommunications markets to competition (emphasis added).

This overarching language makes it clear that Congress intended all telecommunications markets be open to competition, and that in some cases, federal funding would be the catalyst for such competition.

It is both appropriate and in the public interest for federal USF to support a CETC's build-out of networks in high-cost areas. Mr. Schoonmaker concludes (p. 6) that, based on its petition and direct testimony, USCOC intends "to finance the extension of its network to provide an alternative to the service provided by the incumbent LEC." He suggests that USCOC's focus should be to "to provide phone service to those without such." In reality, these goals are complementary and both are fully consistent with the purpose of the federal USF program. As demonstrated in its Petition, USCOC plans to use any USF support that it receives to achieve both objectives.

The Role Of The FCC's Orders

Q. THROUGHOUT THEIR TESTIMONY, MR. BROWN AND MR. SCHOONMAKER ARGUE THAT THE COMMISSION SHOULD APPLY THE REQUIREMENTS RECENTLY SET FORTH BY THE FCC. DO YOU AGREE WITH THEIR TESTIMONY ON THIS ISSUE?

A. No. Mr. Brown and Mr. Schoonmaker are correct that the FCC issued such an order,[3] but I disagree with both their characterization of that order and with their recommendations regarding its application to this proceeding. To be clear, the *2005 USF Order* contains a set filing requirements that the FCC intends to phase in for ETC applicants in those cases in which the FCC evaluates and rules on the petition.

As an initial matter, I am advised that the new ETC designation conditions and reporting requirements adopted in the *2005 USF Order* were not yet effective on the date USCOC filed its Application, and that their legal effect is still pending today. Mr. Brown and Mr. Schoonmaker seek to take USCOC to task for failing to comply with requirements that aren't being imposed by the FCC today – and certainly were not being imposed at the time USCOC's Application was filed – on carriers submitting petitions under Section 214(e)(6). As I understand it, a party is entitled to have its application processed based on the governing requirements in place at the time the petition was filed. Such an approach is fully consistent with the approach taken by the FCC itself in its recent order, in which it declared that only applications filed after the rules become effective would be processed under the new rules.[4]

I also disagree with the suggestion by Mr. Brown and Mr. Schoonmaker that the FCC's *2005 USF Order* made fundamental changes to the governing standards to be met by a carrier seeking designation as an ETC in Missouri. In reality, as the list at pages 9-

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[3] *Report and Order*, FCC 05-46 (rel. March 17, 2005) (hereafter "*2005 USF Order*").

[4] *See* newly adopted 47 C.F.R. Section 54.202(b). We also note that in the *2005 USF Order*, the FCC granted several pending requests for service area "redefinition" associated with ETC designations. In doing so, it explicitly applied the standard in place at the time the petitions were filed: "because the states complied with applicable federal rules and guidelines at the time the redefinition petitions were filed, we decline to upset those determinations. We therefore find that granting these redefinition petitions would serve the public interest" (¶79).

10 of Mr. Brown's testimony illustrates, what the FCC created in this order is best described as additional filing requirements for purposes of an ETC petition filed with the FCC under Section 214(e)(6). In other words, the FCC did not fundamentally change the ETC designation "criteria," as Mr. Brown suggests, but rather changed the way that it plans to require carriers to document their compliance with the existing criteria.

Like the *Virginia Cellular Order*[5] and *Highland Cellular Order*[6] before it, the FCC's *2005 USF Order* reiterates and applies longstanding FCC policy; other than the addition of some new filing requirements, there is nothing that is substantively new or different from the way the FCC has previously addressed these same issues.

Q. WHAT REQUIREMENTS ARE CURRENTLY IN PLACE REGARDING THE DESIGNATION OF A CARRIER AS AN ETC?

A. The language of the 1996 Telecommunications Act, the Code of Federal Regulations, and the FCC's implementation orders combine to form the applicable standard.

USCOC must demonstrate to this Commission that it will offer the "services or functionalities" that are "supported by federal universal support mechanisms"[7] and must do so "either using its own facilities or a combination of its own facilities and resale of another carrier's services" (47 C.F.R. § 54.201(d)(1)) and "advertise the availability of such services and the charges therefore using media of general distribution" (47 C.F.R.

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[5] *Virginia Cellular, LLC Petition for Designation as an Eligible Telecommunications Carrier In the Commonwealth of Virginia*, CC Docket 96-45 (rel Jan. 22, 2004).

[6] *Highland Cellular, Inc. Petition for Designation as an Eligible Telecommunications Carrier in the Commonwealth of Virginia*, CC Docket 96-45, Memorandum Opinion and Order (rel April 12, 2004).

[7] More specifically, the carrier must offer services that contain each of the nine supported service functionalities.

§ 54.201(d)(2)). USCOC must also provide this Commission with the information necessary for it to conclude that the designation of USCOC as an ETC in the requested rural ILEC areas is in the public interest.

Any carrier that is designated as an ETC and receives federal universal service support must then "use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended" (47 U.S.C. § 254(e); 47 C.F.R. § 54.7). Compliance with this requirement is impossible to demonstrate up front (i.e. before the carrier receives an ETC designation for a given area and before any investments are made), but rather is part of the ongoing enforcement process for all ETCs.

Q. YOU STATED THAT THE FCC PREVIOUSLY APPLIED THESE REQUIREMENTS IN ITS *VIRGINIA CELLULAR* ORDER. PLEASE DESCRIBE THE FCC'S CONCLUSIONS AS SET FORTH IN THAT ORDER.

A. Mr. Brown (pp. 8-9) paraphrases the FCC's statements at paragraph 4 of the *Virginia Cellular Order*: "in determining whether designation of a competitive ETC in a rural telephone company's service area is in the public interest, we weigh numerous factors, including the benefits of competitive choice, the impact of multiple designations on the universal service fund, the unique advantages and disadvantages of the competitor's service offering, any commitments made regarding quality of telephone service provided by competing providers, and the competitive ETC's ability to provide the supported services throughout the designated service area within a reasonable time frame." Mr. Brown then characterizes the FCC's statement as one that goes above and beyond the public interest standard previously applied by the FCC, and extends this logic to a

suggestion that the FCC is seeking to discourage ETC designations in rural ILEC study areas. I disagree in both respects. The criteria applied by the FCC in the *Virginia Cellular Order* are not new, and any theory that the FCC intended to somehow "telegraph" a suggestion to the states to deny requests for ETC designations ignores the simple fact that the FCC *approved* Virginia Cellular's request for ETC designation.

While I will discuss each of the topics in greater detail later in my testimony, the following is a summary of how the facts surrounding USCOC's Application apply to the FCC criteria cited by Mr. Brown:

The benefits of competitive choice. The FCC has previously described these benefits, including the opportunity for end users to have competitive alternatives, new services, and lower prices. The FCC has also concluded that an important benefit of competitive entry is the creation of incentives for the rural ILEC to improve efficiency and reduce its network and operating costs. The operation of USCOC as an ETC can be expected to have this effect in the areas for which it seeks designation.

The impact of multiple designations on the universal service fund. The rural ILECs' reliance on this issue as a reason for rejecting USCOC's Application is misplaced for two reasons. First, it ignores the fact that the rural wireline ILECs continue to receive the vast majority of high cost universal service funds and that the size of the fund has increased significantly because the rural ILECs requested (and were granted) a higher level of funding from the FCC. The additional funding received by rural ILECs through the "modified embedded cost" funding mechanism far outweighs any impact on the fund caused by CETCs generally or wireless CETCs specifically. Second, the rural ILECs' analysis is limited by a short run view; as I will explain, the best means of managing the

size of the fund over the long term is to designate one or more CETCs in these areas. The long run impact on the federal fund of designating USCOC as an ETC may be a reduction, not an increase, in the size of the fund.

The unique advantages and disadvantages of the competitor's service offerings. USCOC is proposing to offer a wide range of service plans as an ETC. The best judges of whether these offerings provide benefits to end users are the customers themselves: if they do not perceive a benefit, they will not subscribe to the USCOC service and USCOC will not receive any universal service funding. It should be noted that in its *Virginia Cellular Order*, the FCC concluded (paragraph 29) that the extended coverage, mobility, and larger calling areas offered by Virginia Cellular represented a benefit to customers that was a factor in its analysis. The same conclusion applies to USCOC's service offerings.

Any commitments made regarding quality of telephone service provided by competing providers. Like pricing and other components of customer benefit, service quality is best judged by end user customers: if customers do not perceive that USCOC's offering is of sufficient quality, they will not subscribe to the USCOC service and USCOC will not receive any universal service funding. It should be noted that USCOC has committed to comply with the CTIA *Consumer Code for Wireless Service* in order to ensure consumer protection. This is the same commitment made by Virginia Cellular and accepted by the FCC.[8]

The competitive ETC's ability to provide the supported services throughout the designated service area within a reasonable time frame. USCOC has committed

[8] *Virginia Cellular Order*, ¶ 46.

to use universal service funding received only for the intended uses and will use these funds to increase the quality and coverage area of its services. The FCC has explicitly recognized that its is unlikely that a CETC will be able to offer ubiquitous service prior to receiving USF: "to require a carrier to actually provide the supported services before it is designated as ETC has the effect of prohibiting the ability of prospective entrants from providing telecommunications services."[9] Instead, the FCC has focused on a CETC's ability and willingness to respond to reasonable requests for service.[10]

In summary, USCOC's Application is fully consistent with the FCC's application of the public interest standard in the *Virginia Cellular Order*.

Granting USCOC's Petition is in the Public Interest

USCOC Has Committed To Offer And Advertise The Nine Supported Service Functionalities

Q. HAS USCOC COMMITTED TO OFFER AND ADVERTISE THE NINE SUPPORTED SERVICE FUNCTIONALITIES THROUGHOUT THE PROPOSED SERVICE AREAS?

A. Yes. USCOC made these commitments in its Application, and as described in the testimony of Mr. Lowell and Mr. Wright, the Company stands ready and willing to meet these commitments.

Q. WILL USCOC OFFER SERVICES THAT PROVIDE BENEFITS TO CONSUMERS?

A. Yes. USCOC will provide the residents and businesses in the specified areas with important options. End users will be able to choose the technology – wireline or wireless

[9] *Virginia Cellular Order*, ¶ 17, citing *Declaratory Ruling*, 15 FCC Rcd at 15173-74.
[10] *Virginia Cellular Order*, ¶ 15.

– that best meets their individual needs. End users will also be able to choose from among calling plans that will allow them to more closely match the service that they receive (and pay for) with their calling patterns and frequency. Last, but certainly not least, end users will have greater access to the personal and public safety benefits of wireless service.

Q. AT P. 21, MR. SCHOONMAKER SUGGESTS THAT A POTENTIAL ISSUE ARISES FROM THE FACT THAT USCOC INTENDS "ALL OF [ITS] SERVICE OFFERINGS TO BE ELIGIBLE FOR UNIVERSAL SERVICE." DOES MR. SCHOONMAKER'S STATEMENT MAKE SENSE?

A. No. As Mr. Schoonmaker should be aware, it is carriers, not services, that are designated as ETCs and as qualifying for federal USF support. If a carrier is designated, the FCC's rules require it to submit all of its lines for support. The federal universal service program does not "qualify" lines for eligibility. This issue has been raised and decided in numerous cases and the FCC's rules on this issue have never been in doubt.

ILEC Witnesses Offer No Facts That Are Specific To USCOC Or The Rural Areas In Which It Seeks Designation That Demonstrate That The Requested Designation Would Not Be In The Public Interest

Q. DOES MR. BROWN OR MR. SCHOONMAKER PROVIDE ANY SPECIFIC FACTS RELATED TO ANY OF THE RURAL ILEC SERVICE AREAS THAT WOULD JUSTIFY A REJECTION OF USCOC'S APPLICATION?

A. No. Mr. Brown and Mr. Schoonmaker emphasize that this proceeding should be "fact-specific," but devote the bulk of their testimonies to providing a litany of oft-repeated general concerns and speculation. The facts that are provided by ILEC witnesses are either not relevant to the question at hand or fail to support the arguments that they make.

In the end, the rural ILECs offer no facts that could form the basis of a decision that it is not in the public interest to designate USCOC as an ETC in these areas.

Q. MR. BROWN AND MR. SCHOONMAKER ARGUE THAT THE COMMISSION SHOULD UNDERTAKE A COST BENEFIT ANALYSIS AS IMPLEMENTED BY THE FCC IN THE *VIRGINIA CELLULAR* PROCEEDING. DO YOU AGREE?

A. I have no problem with the application of a cost-benefit analysis in this proceeding as long as both the benefits and costs considered are (1) accurately identified and (2) specific to this proceeding. USCOC has presented facts that are specific to its operation in the Missouri service areas in question. In direct contrast, Mr. Brown describes costs, such as the support of multiple networks,[11] that *might* occur as a consequence of the designation of a CETC, or multiple carriers that have not even applied for ETC status (and then fails to consider the question over anything other than the short run). Mr. Brown's focus is at 30,000 feet when it should be at ground level: any costs to be considered in this proceeding are those that are specific to the details of USCOC's Application or specific to the characteristics of any of the rural ILEC service areas that are the subject of the Application, and the existing rules are to be applied.

Q. MR. BROWN CLAIMS TO HAVE LISTED BOTH COSTS AND BENEFITS OF ETC DESIGNATION AND BELIEVES THAT THE COSTS GREATLY OUTWEIGH THE BENEFITS. DO YOU AGREE?

[11] As I will explain in more detail later in my testimony, the funding of more than one network over the short run may be necessary in order to minimize the size of the fund over the long term. If Mr. Brown is right in his assumption that wireless carriers have lower network costs than wireline carriers, then such a scenario exists in this case: it will be necessary to temporarily fund both a wireline and wireless network in the short run until the more efficient/less costly wireless network can take over and represent the only funded network. This would yield a significantly lower fund size over the long run.

A. No. While he devotes a considerable amount of his testimony to the potential costs of designating an additional ETC, Mr. Brown devotes very little time to a description of the benefits. He does state (pp. 18-19) that benefits might be created by investments that would bring mobile service to currently unserved areas and expand the areas within which customers can use their mobile phones. I agree, although Mr. Brown's assumption that "investments in new towers" is the only way to accomplish such an expansion of coverage is incorrect. He also acknowledges new choices for consumers, lower prices, and higher quality as potential benefits. He is again correct, but his focus is too narrow. The benefit of customer choice applies not only to the introduction of new offerings to existing customers, but also extends to the case of existing offerings being made to customers not previously served. The benefit of lower prices applies to any reductions in the price of existing offerings, but it is also necessary to consider the bundle of services being provided and the price that the customer would have to pay the ILEC for that same bundle of services. Increases in service quality benefit all customers. As Mr. Brown has previously acknowledged[12] the FCC's conclusion that the entry of an additional ETC into a rural area can be expected to create the following benefits: "provide incentives to the incumbent to implement new operating efficiencies, lower prices, and offer better service to its customers." Mr. Brown has also previously acknowledged[13] that the FCC has found "no merit" in the arguments that the designation of an additional ETC in a rural

[12] *See* McLean & Brown's June 25, 2002 white paper *USF Portability – Getting it Right*, p. 2.
[13] *Id.*

area will reduce investment incentives, increase prices, or reduce the service quality of the incumbent LEC.[14]

Mr. Brown also considers (p. 19) "potential competitive responses from other service providers," but then drops the subject and never returns to it in his testimony. This is unfortunate, because his short run view causes him to understate the public benefits of designating a CETC. By utilizing only a static, short-term framework, he understates what is arguably the primary benefit of competitive market forces: the creation of incentives for efficient operation by both incumbent carriers and new entrants.

Q. DOES MR. SCHOONMAKER ACKNOWLEDGE THE FCC'S CONCLUSION ABOUT IMPROVED EFFICIENCIES, PRICES, AND SERVICE?

A. No, in fact he claims (p. 53) the exact opposite: "the introduction of a competitor into a rural environment does not necessarily lead to lower costs or higher quality service for customers. A high-cost market, by definition, is still a high-cost market even after the introduction of competition." I fundamentally disagree. A high cost area may be "high cost" in a rate of return context but may not be, given time, "high cost" if competitive market forces are permitted to operate.

Mr. Schoonmaker also ignores the different cost characteristics of wireline and wireless networks. He poses (p. 53) a rhetorical question: if "it is not economical to provide wireline telephone service to many rural areas – one needs to ask … why we should invite another subsidized competitor into these same areas." In fact, Mr.

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[14] This previous acknowledgment has not deterred Mr. Brown from making contradictory arguments in his testimony in this proceeding.

Schoonmaker's question needs not be rhetorical at all, and has a two part answer. First, as the FCC has consistently observed, the introduction of competitive market forces will create incentives for all providers to increase network and operational efficiency and to be more responsive to customer needs. Over the long run, it may be possible to support only one carrier in that area (and potentially not to provide support at all), but without competitive entry by a second ETC it will be impossible to identify the more efficient carrier. Second, Mr. Schoonmaker focuses on whether it is economical for a wireline network to serve an area. It is possible that a given area may be economically served by a wireless carrier but not by a wireline carrier, or *vice versa*. If competitive entry is not made possible through the use of federal high-cost support, we will never know the answer.

Q. IS THERE SOME FACT OR ISSUE THAT IS SPECIFIC TO USCOC, OR THE SERVICE AREAS WITHIN WHICH IT SEEKS ETC DESIGNATION IN MISSOURI, THAT WOULD OUTWEIGH THE BENEFITS OF USCOC'S ETC DESIGNATION?

A. No, as discussed above.

The Assertion By Mr. Brown That USCOC Will "Misuse" USF Funds Has No Factual Basis Whatsoever And Belies A Misunderstanding Of The Federal USF Mechanism

Q. WHAT MECHANISM IS IN PLACE TO ENSURE THAT FEDERAL UNIVERSAL SERVICE SUPPORT IS USED "ONLY FOR THE PROVISION, MAINTENANCE, AND UPGRADING OF FACILITIES AND SERVICES FOR WHICH THE SUPPORT IS INTENDED"?

A. To ensure that the use of support funds by any ETC (incumbent or competitor) complies with this requirement, a system of checks and balances are in place. The Commission

has both the ability and responsibility (pursuant to 47 C.F.R. § 54.314(a)) to ensure that any funds received by USCOC or any other ETC (including the ILECs) are being used appropriately. Through the annual recertification process, the Commission has an ongoing role in ensuring that funds are being properly used. Annual recertification is necessary for any ETC to continue receiving federal USF support. State regulators are required to file annual certifications with the FCC and the Universal Service Administrative Company ("USAC") stating that the rural ILECs, and any CETC providing service in the service areas of rural ILECs, are using federal USF support only for the provision, maintenance and upgrading of facilities for which the support is intended. If an ETC does not make such a demonstration to the Commission's satisfaction, the Commission may opt not to certify that carrier as an ETC for the upcoming year. USAC also has the authority to conduct audits and does so on a regular basis. Finally, wireless carriers, including USCOC, are licensed by the FCC, which has the authority to investigate the operation of wireless companies and institute punitive measures if it deems them necessary.

Q. MR. BROWN ARGUES THAT USCOC WILL USE USF FUNDS IN AN IMPROPER MANNER. DOES THIS ARGUMENT HAVE ANY MERIT?

A. No. With no factual support whatsoever, he alleges (pp. 12-13) that USCOC has used, or intends to use, federal support funds in an inappropriate manner. When the reasoning behind his allegations is examined more closely, it becomes clear that Mr. Brown actually has no basis for an assertion that the funds will be used improperly; he simply doesn't agree with the way in which wireless carriers are permitted to use the funds. Mr. Brown argues (pp. 12-13, 17, 46) that all funds should be used to expand geographic

coverage through the construction of new cell sites. There are three fundamental problems with Mr. Brown's opinion: (1) while tower construction is one means of expanding coverage, it is not the only means (or necessarily the most desirable means), (2) coverage expansion is one way that federal universal service funds can be used, but it is not the only permitted use, and (3) Mr. Brown ignores the basic operation of the federal USF; high-cost funds are received if, but only if, a carrier serves customers in high cost areas. If USCOC only serves customers in what Mr. Brown refers to as "more densely populated" (and therefore presumably lower cost) areas, it will receive either a level of funding consistent with these lower cost areas or it will receive no high cost funding at all. Additionally, 47 U.S.C. § 254(e) and 47 C.F.R. § 54.7 state that "a carrier that receives federal universal service support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." I have reviewed both closely, and can state with some confidence that nowhere in the 1996 Act or FCC rules does the requirement "a wireless carrier that receives federal universal service support shall use that support only for the construction of new towers" appear.

Just as the rural ILECs have done, USCOC is allowed to use federal USF support to provision, maintain, and upgrade its facilities and services. Some of these funds may go to expand coverage, while others can be used to maintain the network, improve service quality or to operate network facilities in high cost areas. If Mr. Brown's premise is applied in a competitively neutral fashion, then the use of support by ILECs, who today have mature networks that were constructed long ago, would have to be reexamined.

The Brown/ Schoonmaker Suggestion That USCOC Be Required To Submit Long Range Service Improvement Plans Is Unnecessary

Q. MR. BROWN (PP. 39, 43) AND MR. SCHOONMAKER (PP. 11, 28, 32) RECOMMEND THAT THE COMMISSION ADOPT THE FCC'S FILING REQUIREMENT OF A FIVE-YEAR SERVICE IMPROVEMENT PLAN. DO YOU AGREE THAT THIS RECOMMENDATION HAS MERIT?

A. No. In my experience, CETC service improvement and buildout plans are not the panacea that Mr. Brown and Mr. Schoonmaker make them out to be for several reasons. First, the capital planning cycles of most carriers do not extend to a five-year horizon. In many cases, changes in the availability of capital, market conditions, and customer demands can make even an annual planning cycle difficult and subject to frequent revision. This level of uncertainty is a fact of life in competitive markets and largely reflects carriers' ongoing efforts to be as responsive as possible to customers and potential customers.

Second, it is important to note that the plans that have been required by the FCC to date are not binding and are explicitly subject to revision based on changes in customer needs.

Third, this kind of long-range projection, that after the first twelve months often represents little more than an educated guess, is not the most effective means available for the Commission to ensure that a carrier maintains the "capability and commitment" to "respond to reasonable requests for service," and that federal USF support is being used for the intended purposes. Instead, it is much more effective for the Commission to review all ETCs' progress toward reaching the stated objectives in the context of the annual recertification process for monitoring the use of federal USF support.

Fourth, the FCC's filing requirement set forth in the *2005 USF Order* should be considered in its proper context. The requirement was adopted in response to a

recommendation of the Joint Board and applies in proceedings under Section 214(e)(6) when the FCC is making the designation decision.

Q. MR. BROWN SUGGESTS THAT USCOC SHOULD NOT BE DESIGNATED AS AN ETC BECAUSE HE HAS QUESTIONS REGARDING THE USE OF USF SUPPORT BY ANOTHER CARRIER IN ANOTHER STATE. ARE MR. BROWN'S MUSINGS IN THE AREA RELEVANT?

A. No. Unable to find anything negative to say about USCOC's use of federal USF in the other states where it has been designated, Mr. Brown resorts to an "argument by innuendo" strategy of describing (pp. 12-13) what he thinks is improper use of funds by another carrier (Western Wireless) in another state (Wyoming). Mr. Brown's first mistake is to again focus exclusively on the construction of new towers. While the construction of towers is a permitted use of federal USF, it is far from the only way for a carrier to use these funds for the 'provision, maintenance, and upgrading of facilities and services" in that area, and in fact is not even the only way that Western Wireless could use in order to "expand its service footprint into rural and high-cost areas of Wyoming" (something that Mr. Brown, with no factual basis at all, asserts that it has not done). Mr. Brown's second mistake is to assume that if he does not know the answer to a question, then it is safe to assume that no one does. He poses the rhetorical question "Where did the money go?" Mr. Brown may not know, but this does not mean the answer is unknown. In the end, of course, what Western Wireless has or has not done in Wyoming has absolutely nothing to do with what USCOC will or will not do in Missouri. Mr. Brown's uninformed speculation provides absolutely no relevant information to the Commission regarding the merits of USCOC's request for ETC designation in this case.

The ILEC Suggestion That USCOC Should Be Subject To Additional Requirements Is Unnecessary And Duplicative

Q. AT PAGES 19-22 OF HIS TESTIMONY, MR. SCHOONMAKER CLAIMS THAT USCOC SHOULD NOT BE DESIGNATED AS AN ETC BECAUSE ITS SERVICES ARE NOT AFFORDABLE. DO YOU AGREE?

A. No, for several reasons. As an initial matter, there is a very practical reason why USCOC's rates - however characterized - should not preclude ETC designation: if end user customers do not consider USCOC's service offerings to be affordable and a good value (considering price, quality, mobility, and features), they will not subscribe to them. Federal high-cost support is available on a per-line basis for customers actually served. If customers do not subscribe to its services, USCOC will not receive support.

Second, Mr. Schoonmaker compares (p. 20) "local rates" of the rural ILECs members and what he characterizes as "local rates" for USCOC. Such an analysis is meaningless: Mr. Schoonmaker is comparing service offerings with different local calling areas and with very different bundles of features and capabilities. Mr. Schoonmaker goes on (p. 29) to urge the Commission to "carefully consider" the ILEC rate plans compared to USCOC's rate plans. I agree that such a careful consideration is in order: if the Commission carefully reviews what is included in the services offered by the ILECs and in the services offered by USCOC, it will be abundantly clear that Mr. Schoonmaker's simplistic approach of comparing nominal prices provides no useful information. If the service offerings are compared on an apples-to-apples basis, it is likely that USCOC's prices are competitive and can provide a competitive alternative to end users, *if* USCOC has the opportunity build out its network so that its offerings are a viable substitute service. Measured apples-to-apples, the average revenue per subscriber for wireless is lower than that for rural ILECs.

Third, Mr. Schoonmaker's argument that it would not be in the public interest to support these "considerably higher" rates seems to suggest a mistaken belief that higher priced services will be eligible for a higher level of support. This is not the case: the per-line support amount that would be available to USCOC is a fixed amount that is in no way related to USCOC's retail rate. High-cost funds would not be "supporting" USCOC's services (whether affordably priced or "high priced"), they would be supporting investment in network infrastructure in rural areas. Moreover, Mr. Schoonmaker is not suggesting that ILECs not receive support for their high revenue customers who purchase vertical services or DSL. Of course, there would be no funding available to USCOC at all if customers conclude that USCOC's service is not affordable.

Fourth, Mr. Schoonmaker's suggestion (p. 21) that the designation of USCOC as an ETC would not be in the public interest because USCOC "has given no indication... that it would reduce rates if it is designated an ETC" accounts for only short run considerations.[15] As the FCC has pointed out, perhaps the primary public benefit over the long run of designating a CETC is the creation of incentives for both the incumbent carrier and new entrants to become more efficient. Increased efficiency in a competitive market is likely to lead to lower prices over time. A decision by USCOC or any other ETC to invest support funds in new infrastructure rather than to use the funds to offset a short term rate reduction supports this long term objective.

Fifth, Mr. Schoonmaker's conclusion is inconsistent with his testimony taken as a whole in two respects. To put a rather fine point on it, if Mr. Schoonmaker truly believed

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[15] It is also unclear that funds that may only be used for the provisioning, maintenance, and upgrading of facilities could instead be used to reduce retail rates. Mr. Schoonmaker may be attempting to criticize USCOC for complying with federal law.

that USCOC's prices are so high that it poses no competitive threat to his clients, the ILECs' financial stake in this proceeding would be effectively zero, and they would have no real basis for opposing USCOC's petition (nor would they be likely to expend the resources necessary to do so). Of course, *by definition* what a Rural ILEC sees as a competitive threat is seen by the customer as an opportunity to purchase a more desirable service. Additionally, as I address later in my testimony, Mr. Schoonmaker asserts that USCOC's geographic coverage in insufficient for designation as an ETC. While I disagree with that conclusion, it shows that Mr. Schoonmaker is again internally inconsistent: he does not explain how a carrier that seeks to properly use federal USF to expand its network coverage can do so if it has devoted those funds to rate reductions.

Finally, to the extent that Mr. Schoonmaker is suggesting that the Commission should be in the role of determining whether USCOC's rates are affordable, then I must respectfully disagree: the level at which rates are considered to be affordable is an issue for *customers* to decide. Customers are in the best position to determine whether a particular service offering a given price will be beneficial to them. The Commission must determine if USCOC has committed to offer and advertise the nine supported service elements. If this commitment has properly been made, it is then up to end users to decide whether to purchase USCOC's service at a given price (so that USCOC receives federal USF support) or not to purchase USCOC's service at that price (so that USCOC receives no federal USF support).

Q. IN YOUR PREVIOUS RESPONSE, YOU MENTIONED THE IMPORTANCE OF AN "APPLES-TO-APPLES" COMPARISON OF RATES. WOULD SUCH A COMPARISON SUPPORT MR. SCHOONMAKER'S ARGUMENT THAT USCOC'S SERVICES ARE LESS AFFORDABLE THAN COMPARABLE ILEC

SERVICES?

A. No. For example, a customer in the Halltown exchange could sign up for USCOC's $35 plan and gain the ability to make 700 minutes of calls terminating anywhere in Missouri or the rest of the contiguous United States without paying long distance toll charges. If that customer took wireline service, they might pay Choctaw Communications' basic residential rate of $9.90, which only gives the customer the ability to make calls terminating within the Halltown exchange. According to Choctaw's 2002 Annual Report, that exchange has only 559 residential lines and 72 business lines. To call beyond those 631 lines, the customer could select Choctaw's Extended Area Service for an extra $11.45 per month to receive the ability to make calls to numbers within the Springfield metro calling area.

Beyond that area, the customer would need to pay for long distance. Choctaw's (choctawtel.com) web site advertises two long distance rate plans offered by Mokan Communications. One costs 15 cents per minute, which means that a Choctaw EAS customer making 100 minutes of calls to points across the state or just a few miles away would pay $36.35 per month (not including vertical features such as Caller ID, which are included in USCOC's rates but range from $2.00 to $5.00 additional per month if purchased from the ILEC). The other plan costs 10 cents per minute, with a monthly rate of $4.95. Under this plan, the customer making 100 minutes of calls beyond the EAS area would pay $36.30 (again excluding vertical features). This is more than USCOC's monthly rate of $35, and the ILEC's wireline service would not give the customer the benefit of mobility. To make a call when away from home, the customer would first have to find another wireline phone, and then, if they use a Mokan calling card, they would

pay 20 cents per minute plus a surcharge of 50 cents per call. For many people the $35 USCOC plan is likely to represent a better value.

As another example, a customer in the Granby exchange can select USCOC's $25 local rate plan and gain the ability to make 125 minutes of calls to anywhere in the contiguous United States without paying long distance toll charges. Under a wireline residential rate plan, the same customer would pay the Granby Telephone Company basic rate of $6.60 per month for a local calling area of only two exchanges. Granby's website (jscomm.net) advertises long distance provided by Stouffer Communications offered at 15 to 17 cents per minute for in-state long distance. Thus, a Granby customer making 100 minutes of calls within Missouri but outside those two exchanges would pay $21.60 to $23.60 per month, excluding vertical features which cost an additional $3.00 to $4.95 per feature per month. A host of vertical features come standard with USCOC's service, and the Granby customer would likely pay significantly more than $25 per month to receive even some of those features on their wireline plan. Also, of course, a Granby customer would not have mobility, no matter how much they pay their local telephone company.

Q. DOES IT MAKE ANY SENSE TO SUGGEST THAT IT WOULD SOMEHOW BE IMPROPER TO USE FEDERAL USF TO PROVIDE CALLING PLANS THAT INCLUDE WHAT THE ILEC'S SELL AS "LONG DISTANCE" SERVICE?

A. No. USCOC has proposed to use all of its support is used to build, maintain and upgrade its network. While all ETCs must provide services that include the nine supported functionalities, there is no prohibition, or even suggestion of a prohibition, that the support can only be used to provide services to those customers who purchase only the supported functionalities.

A narrow view that a CETC is somehow limited in how it defines its local calling areas is not shared by the FCC, which has repeatedly and consistently noted that a primary benefit of CETCs, particularly wireless ETCs, is the larger local calling areas made available to consumers.

Q. MR. SCHOONMAKER SUGGESTS (PP. 25, 42-43) THAT USCOC'S RATES ARE NOT AFFORDABLE IN PART BECAUSE USCOC REQUIRES SOME CUSTOMERS TO SIGN UP FOR A MINIMUM CONTRACT PERIOD WITH AN EARLY TERMINATION FEE. DO YOU AGREE?

A. No. Wireless providers, including USCOC, make customer equipment (telephones) available to their customers at steeply discounted prices (sometimes for no additional charge). As Mr. Schoonmaker is surely aware, the contract period required by wireless carriers for many service plans is in place in order to ensure that the cost of this equipment can be recovered. In effect, the customer is permitted to pay for a handset with the features that they want over time rather than having to make a large up-front investment. There is nothing pernicious or misleading about such a pricing structure, and the price actually being paid for the underlying service does not change. I am not aware of any case, whether at the FCC or before a state regulator, in which a request for ETC designation was denied because a wireless carrier required a contract period when discounted equipment was being provided.

Q. MR. BROWN (P. 44) AND MR. SCHOONMAKER (PP. 15, 29) SUGGEST THAT USCOC SHOULD BE REQUIRED TO OFFER UNLIMITED LOCAL USAGE AS A CONDITION OF BEING DESIGNATED AS AN ETC. DO YOU AGREE?

A. No. The FCC's rules do not require that an ETC provide "unlimited local usage," and the FCC has consistently refused to create such a requirement because it would not be

consistent with the best interest of end user customers. Any suggestion that unlimited local usage (or any other minimum local usage requirement) means that local usage is being provided "for free" to the customers is a mistaken one; in reality, a flat-rated service offering simply means that customers are buying – and paying for – a fixed bundle of usage that corresponds to average customer usage. Some customers will use fewer minutes but still pay for the average amount, while others will use more minutes and benefit by paying for only the average. In contrast, USCOC's service plans allow the customer to make a choice regarding the amount of usage that he or she wishes to pay for. This choice can be based on a consideration of total calling volume and with the scope of the geographic area that the customer wishes to include. It would be equally unnecessary to require ILECs to offer a minimum local calling area of 100,000 access lines as a condition receiving high-cost support.

Q. MR. SCHOONMAKER ARGUES (PP. 38-44) THAT THE COMMISSION SHOULD IMPOSE SERVICE QUALITY STANDARDS ON USCOC IN ORDER TO PROTECT CONSUMERS. IS THIS ACTION NECESSARY?

A. No. Ultimately, the service quality issue is moot for the same reason that the affordability issue is moot; not because affordability and service quality aren't important to end user customers, but because they are. Assuming an alternative is available, customers will not subscribe to services if they consider the price too high or the quality too low. If USCOC fails to meet customers' expectations regarding affordability and service quality, it will not receive federal high cost support.

By basing support on a per-line basis and making it available (at least to CETCs) only when a customer is actually served, the FCC created a dynamic in which the

marketplace can sort out these issues. In the final analysis, it doesn't matter what Mr. Schoonmaker thinks of USCOC's pricing or service quality,[16] it matters what the customers and potential customers of USCOC's service think. If anything, the designation of USCOC as a CETC will provide it with an even greater incentive to ensure that customers see its services as affordable and high quality because federal support dollars will be at stake. Either way, the program mechanism is such that market forces can be relied upon to provide the proper incentives to CETCs, including USCOC.

In addition to being duplicative of market forces (and therefore providing no incremental benefit), the additional requirements proposed by Mr. Schoonmaker would create no public benefit because they would act as effective barriers to entry to a wireless carrier requesting ETC designation.

It is also important to remember the history of carrier regulation when making public interest determinations. The regulatory constraints currently imposed on ILECs are not there because the ILEC is an ETC; they were imposed because of the ILEC's position in the marketplace as a monopoly provider of local exchange service. The ILECs' unique position makes it appropriate for regulators to enact standards for service quality and customer service operations.

[16] To the extent that Mr. Schoonmaker is a customer or a potential customer of USCOC's service, these opinions are important because they will determine whether USCOC receives monthly support for the lines they decide to purchase or not to purchase. From this perspective, it is possible to place a dollar value on this witness's opinions on these issues.

Q. MR. SCHOONMAKER SUGGESTS (PP. 43-44) THAT THE IMPOSITION OF SERVICE QUALITY STANDARDS ON USCOC IS NECESSARY IN ORDER TO ENSURE "COMPETITIVE NEUTRALITY." IS HE RIGHT?

A. No. The FCC's principle of competitive neutrality requires that all universal service rules, including those governing the process of qualifying for and receiving universal service support, must be competitively neutral; it does not anticipate that the ILEC and CETC should be treated identically. The concept of regulatory parity means regulating carriers in a competitive market in a similar fashion. The amount of USF support previously received and the existing level of market power exercised by ILECs justifies some disparity in regulatory treatment that is independent of the administration of the universal service mechanism. The FCC has made clear that a CETC need not be an ILEC (*1997 First Report & Order*), nor need it be regulated as a monopoly carrier as a condition of ETC status (*2005 USF Order*). From a policy perspective, the much better outcome is for competition to drive incremental deregulation of ILECs.

Q. YOU STATED THAT REQUIRING USCOC TO MEET MR. SCHOONMAKER'S SUGGESTED ADDITIONAL REQUIREMENTS WOULD SERVE AS A BARRIER TO ENTRY. PLEASE EXPLAIN.

A. If competitive carriers were required, before ETC designation (and on a yearly basis thereafter), to meet the service area and quality standards that as ILEC is required to meet, any sort of competitive entry would be impossible and the main purpose of universal service funding would be thwarted, namely the *buildout* of quality competitive services in rural and high-cost areas. As noted by the Regulatory Commission of Alaska:

> The FCC has previously rejected rural incumbent carriers' suggestions to adopt eligibility criteria beyond those set forth in Section 214(e) to prevent competitive carriers from attracting only the most profitable customers, providing substandard service, or

> subsidizing unsupported services with universal service funds. The FCC concluded that the statutory requirements limiting ETCs, and requiring them to offer services throughout the area and to use the support only for the intended services, were sufficient. Similarly, we find little evidence that further protections are needed to protect MTA's place in the market.[17]

More importantly, customers will dictate USCOC service quality standards. Customers will decide whether or not to choose USCOC services; if they are of sufficient quality, USCOC will gain both customers and support. If USCOC services are not of sufficient quality, it will not gain customers and will not receive USF support.

Q. WHAT SPECIFIC COMMITMENTS HAS USCOC MADE REGARDING SERVICE QUALITY AND CUSTOMER SERVICE?

A. As set forth in its petition, USCOC has committed to adhere to the CTIA Consumer Code for Wireless Service.

Q. MR. SCHOONMAKER SUGGESTS (P. 43) THAT THE CTIA CODE DOES NOT PROVIDE ADEQUATE CONSUMER PROTECTIONS. DO YOU AGREE?

A. No, and neither does the FCC. In its *Virginia Cellular Order*, the FCC (¶30) noted that "as evidence of its commitment to service quality, Virginia Cellular has also committed to comply with the Cellular Telecommunications Industry Association Consumer Code for Wireless Service, which sets out certain principles, disclosures, and practices for the provision of wireless service." The FCC concluded that Virginia Cellular's commitments "adequately address any concerns about the quality of its wireless service."

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[17] *Order No. 10 in Docket No. U-02-39*, Regulatory Commission of Alaska, August 28, 2003, approving the application of Alaska DigiTel, LLC for ETC designation.

The Existing Federal USF Mechanism Does Not Create A "Windfall" For Wireless Carriers

Q. MR. BROWN ARGUES (P. 13) THAT THE EXISTING MECHANISM OF BASING A CETC'S USF SUPPORT ON ILEC COSTS CREATES DISTORTED INCENTIVES AND SUGGESTS (P. 49) THAT USF SUPPORT COULD PROVIDE AN UNDESERVED "WINDFALL" TO WIRELESS CARRIERS SUCH AS USCOC. DO YOU AGREE?

A. No. To his credit, Mr. Brown does acknowledge (p. 13) that this issue is "well beyond the scope of this proceeding." I agree. Yet, Mr. Brown then tries to draw it into the current discussion by suggesting that the existing mechanism for determining per-line support creates an increased need for long range service improvement or build-out plans. There is no logical connection between these issues.

In each of the ETC designation proceedings in which I have participated, ILEC witnesses have routinely argued that wireless providers, due to differences in network design and operations, have a lower per-line cost to serve customers in rural areas. Basing the wireless CETC's support on the higher ILEC costs (per the FCC's rules), the ILECs argue, provides a "windfall" to the wireless CETCs. Unfortunately both Mr. Brown and Mr. Schoonmaker (p. 56) have used such an argument in this proceeding.

There are two equally important points to be made about the "windfall" hypothesis. Even if USCOC's per-line costs prove to be lower than those of the rural ILECs,[18] no "windfall" can occur: the rules specifically limit USCOC's use of these funds to the "provision, maintenance, and upgrading" of network facilities in its ETC service area. On the other hand, if one assumes the possibility of a "windfall" and then realizes that such a "windfall" will only occur if USCOC's per-line costs are indeed

[18] Neither witness offer an explanation of why a mechanism that encourages investment by a lower cost/more efficient provider is not in the public interest (or conversely, why a decision to fund the higher cost/less efficient provider into perpetuity represents sound public policy).

lower, the worst outcome that can be realized is that the carrier that all parties agree is a more efficient provider will be encouraged to build out its network on an accelerated basis. Once this buildout is complete, support can be based on this more efficient network (and ultimately limited to this single efficient carrier) thereby minimizing the size of the fund over the long run. There is a rather direct answer to the common ILEC question: why should we invite another subsidized competitor into these same areas? Because by doing so a more efficient provider can build out its network to serve customers. It should be noted that cable television providers have not sought ETC designation in rural areas, largely because construction of additional wireline networks in rural areas under the "per line" support methodology does not enable competitive entry by a less efficient wireline provider. USCOC has committed, as it must, to use all support funds to build out, maintain and operate network infrastructure in these rural areas; a result that is fully consistent with the stated purposes of the Act and the interests of Missouri end user customers.

ILEC Claims Regarding A Possible Impact On The Size Of The Federal USF Fund Are Based On A Strictly Short-Run View, Are Disingenuous At Best, And Are Well Beyond The Scope Of This Proceeding

Q. MR. BROWN (PP. 4, 11, 19-20, 45-46) AND MR. SCHOONMAKER (PP. 75-78) SUGGEST THAT IN ORDER TO CONTROL THE GROWTH OF THE FEDERAL UNIVERSAL SERVICE FUND, THE COMMISSION SHOULD NOT DESIGNATE USCOC AS AN ETC IN MISSOURI. DO YOU AGREE WITH THEIR FACTS OR REASONING?

A. No. Both Mr. Brown and Mr. Schoonmaker make misleading statements regarding the FCC's position on fund growth: Mr. Brown suggests (p. 11) that the FCC instituted new ETC designation guidelines in order to "address the rapid growth in the amount of

funding that is going to competitive ETCs," while Mr. Schoonmaker states (p. 45) that "the FCC is, undoubtedly, concerned about the national implications of individual state commissions' ETC decisions and their collective effects on the federal USF." Neither statement tells the whole story. In reality, the FCC has not limited its concerns to the designation of CETCs at all, but has also consistently expressed concern regarding growth in support to rural ILECs: "We recognize that high-cost support to incumbent ETCs has grown significantly in real and percentage terms over the same period."[19]

While significant growth in the federal high-cost fund has occurred, it would be extremely misleading (and intellectually dishonest) to characterize this growth as being due primarily to wireless competitive entry in high cost areas. In reality, federal fund growth has been a function of – in this order – (1) the transition from implicit to explicit subsidies, (2) the decision by the FCC to provide funding to the rural ILECs on the "modified embedded cost" mechanism described below, and – as a distant number (3) – the designation of CETCs, including but limited to wireless ETCs.

Q. DO YOU AGREE THAT THE FEDERAL HIGH-COST FUND MUST BE PRUDENTLY MANAGED?

A. I do, but I strenuously disagree with the strictly short-term perspective of the rural ILECs. By limiting entry by carriers as an ETC, the size of the fund will be kept small over the short run, but will be larger than necessary over the long run. As the FCC has consistently concluded, the entry of a competitive ETC can be expected to provide incentives for the ILECs to improve both efficiency and service quality. The way to

[19] *Virginia Cellular Order*, ¶ 31.

minimize the size of the federal USF over the long run is to ensure that only the most efficient network is ultimately funded. The efficient network for a given high cost area may be wireline or wireless, and may be provided by the ILEC or a CETC. The only way to identify the efficient network configuration is to permit CETCs to serve an area on an equal footing with the ILEC.

It is possible that the ILECs are, or have the capability to become, the low-cost network solution for serving high cost areas. Of course, it is quite possible that another carrier can serve the area more efficiently. Because wireless and wireline costs vary in different ways, it is possible that wireless represents a lower cost solution to serve many areas that are high cost for the wireline ILEC. The only way to reach this efficient solution is to make ETC designations on a technology neutral basis.

Consistent with the conclusions of the FCC and the Fifth Circuit Court of Appeals, the fund should be managed on a long-term basis in a way that focuses on benefits to consumers, not carriers. The ILEC's suggestion that additional ETC designations simply mean an increase in demand on the fund is an example of such a short-run, static perspective. Prudent management of the high-cost fund by the FCC, including an effort to minimize the size of the fund over the long-run, is not inconsistent with a mechanism that results in a short-run increase. To the contrary, an attempt to minimize the size of the fund on a quarter-by-quarter basis will almost certainly result in a larger than necessary fund over the long run (while simultaneously reducing competitive alternatives available to consumers in rural areas).

Currently, an observation that support to competitive ETCs has grown over the past two years simply means that the process of ETC qualification and provisioning of

qualified lines by CETCs is working exactly as intended by the FCC. As competitors enter rural markets, support to carriers other than the incumbent LECs will inevitably grow. This should not be viewed as an adverse or unintended consequence. In the long run, growth in support to CETCs vs. growth in support to ILECs is useful only as a barometer of how well the process is working. In an environment of truly portable support, the relative amount of support going to CETCs and ILECs would have no impact on the overall size of the fund. Under such a mechanism, the relative amount of support going to each type of ETC would be viewed as exactly what it is: a measure of the success (or lack of success) of competitive entry.

Under the FCC's current mechanism, growth in the support to CETCs is a measure of growth in new investment in rural areas. Support to ILECs may or may not represent new investment, and most likely represents costs associated with the operation of a network whose efficiency has not been tested by competitive market forces. By making it possible for a competitor to build out sufficient network infrastructure to meet the needs of customers in these rural areas, options of the future are expanded. If USCOC's network costs are indeed lower, the carrier that is the more efficient provider will be encouraged to continue to build out and improve its network on an accelerated basis. If this is accomplished on a going-forward basis, support can be based on this more efficient network (and ultimately limited to this single efficient carrier) thereby minimizing the size of the fund over the long run.

Q. YOU STATED THAT AN FCC DECISION REGARDING ILEC COST RECOVERY HAS CONTRIBUTED MORE TO THE GROWTH IN THE FEDERAL USF THAN THE DESIGNATION OF COMPETITIVE ETCS. PLEASE EXPLAIN.

A. The largest contributors to the size of the federal fund are the compromise elements that were included by the FCC *for the benefit of rural ILECs*. What Mr. Brown and Mr. Schoonmaker neglect to mention in their testimony is that the size of the high-cost loop fund is in large part a direct function of the FCC's decision to give the rural carriers, including their clients in this case, an extended transition period in which to improve their efficiency, reduce their costs, and better prepare themselves to operate in a competitive market. These elements of the mechanism, implemented at the request of and for the exclusive benefit of rural ILECs, represent a far greater impact on the size of the fund than any of concerns cited in this case.

For the current interim mechanism, the FCC set aside its consistent (and economically valid) position that universal service funds should be sufficient to permit the recovery of a carrier's forward-looking economic costs, but not necessarily its embedded costs. In fact, the FCC did the rural ILECs one better, and adopted a modified embedded cost mechanism that is projected to increase the size of the high-cost fund by *$1.26 billion dollars* over the amount that would have been required by the existing embedded cost mechanism.[20] To my knowledge, no estimate of the impact on the fund size caused by the decision to permit rural ILECs to recover embedded, rather than economic, costs has been published.

In economic terms, the decision to permit rural ILECs to recover embedded costs represents a dead weight loss. It is an inefficiency that is being institutionalized into the existing cost structure for the duration of the interim mechanism. Rural ILECs are the

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[20] *Id.*, ¶ 28. It should be noted that this estimate was provided by the Joint Board and Rural Task Force, and not by some party opposing the adoption of the modified embedded cost mechanism.

sole beneficiaries of this element. Not surprisingly, the FCC has put the rural ILECs on notice that this windfall exists only for the duration of the interim mechanism:

> Although we agree with the Rural Task Force that a distinct rural mechanism is appropriate at this time, we believe that there may be significant problems inherent in indefinitely maintaining separate mechanisms based on different economic principles. The Commission previously determined that support based on forward-looking cost is sufficient for the provision of the supported services and sends the correct signals for entry, investment, and innovation. Many commenters representing the interests of rural telephone companies argue that the Rural Task Force's analysis conclusively demonstrates that the forward-looking cost mechanism should not be used to determine rural company support and that only an embedded cost mechanism will provide sufficient support for rural carriers. We disagree. While the Rural Task Force demonstrated the inappropriateness of using input values designed for non-rural carriers to determine support for rural carriers, we do not find that its analysis justifies a reversal of the Commission's position with respect to the use of forward-looking costs as a general matter."[21]

The FCC also noted its agreement with the Joint Board that "to the extent that it differs from forward-looking economic cost, embedded cost provides the wrong signals to potential entrants and existing carriers."[22] I agree. More important in the current context, to the extent it differs from forward-looking economic cost embedded cost inflates the size of the high-cost fund to a level well above that which would otherwise be necessary. For these reasons, the FCC has initiated a proceeding to examine how support is calculated for both rural ILECs and CETCs.[23]

A second element of the interim federal universal service mechanism for rural areas, again included for the sole purpose of benefiting rural ILECs, is the modification

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[21] *Fourteenth Report and Order*, ¶¶ 173-174 (footnotes and paragraph numbering omitted).
[22] *Id.*, ¶ 174 and footnote 406.
[23] *Public Notice, Federal-State Joint Board on Universal Service Seeks Comment on Proposal to Modify the Commission's Rules Relating to High-Cost Universal Service Support,* FCC 05J-1 (rel. Aug. 17, 2005).

of the concept of "portability." The FCC's decisions regarding the portability of these funds in rural areas are responsible for a portion of the increase in fund size. In its recommendation, the Joint Board set forth several options for limiting support to a customer's "primary line." Limiting support in this way would have reduced the size of the federal fund and would have enabled regulators to better manage the size of the fund in the future. Because the adoption of a "primary line" proposal could have resulted in a reduction in the USF support that they receive, the rural ILECs pushed for – and were able to get passed – a provision in the *2005 Consolidated Appropriations Act* that, in the FCC's words, "prohibits the Commission from utilizing appropriated funds to 'modify, amend, or change its rules or regulations for Universal Service support payments to implement the February 27, 2004 recommendation of the Federal-State Joint Board on Universal Service regarding single connection or primary line restrictions on universal service payments."[24]

In this light, the ILEC suggestion that the Commission deny USCOC's Application as a method of limiting growth of the fund is disingenuous at best. In the simplest terms, the facts are as follows: (1) rural ILECs have asked for and received various protections from the impact of competition as a part of the interim mechanism, (2) these protections cause the size of the high-cost fund to increase, and (3) the rural ILECs are now using the fact that the fund is growing to support an argument that actual competitive entry should be limited. Rural ILECs completely ignore the fact that these assurances of cost recovery in rural areas are a gift from the FCC; they would not exist in a competitive marketplace. The transition mechanism adopted by the FCC may be costly

[24] *2005 USF Order*, ¶ 11.

in the short term, but it can serve to gradually wean the incumbent rural LECs over the period of time that it is in effect. However, such weaning will only take place if competitors are permitted to enter the market with ETC status.

If the interim universal service mechanism is implemented fully, the long-term result will be the maximum benefit to the consumers of telecommunications services in rural areas and to rural economic development. Rural ILECs can use this transition period, and the windfall generated by the guarantee of embedded cost recovery and the receipt of universal funds for customers not currently served, to update their networks, streamline their operations, and prepare for competition. The piecemeal implementation of this policy favored by the rural ILECs would inevitably harm rural consumers. Permitting multiple ETCs to operate in an area prior to incumbent rural LECs being given the time to wean themselves could, the FCC concluded, cause financial distress to the rural ILECs and disruptions in service. Equally important, permitting the guarantee of embedded cost recovery and the receipt of a constant amount of universal funds (regardless of the number of retail customers actually being served), but refusing the certification of multiple ETCs, such as USCOC, gives the rural ILECs no incentive to act during this interim period to increase their efficiency and prepare for the day that they will actually be subject to competitive market forces.

Mr. Brown's Argument That USCOC Should Not Be Designated As An ETC Because It Is Already Providing Service In Rural Areas Ignores How Carriers, Including ILECs, Enter And Serve Markets

Q. MR. BROWN ARGUES THAT USCOC'S REQUEST FOR ETC DESIGNATION SHOULD BE DENIED BECAUSE USCOC IS ALREADY PROVIDING SERVICE IN THE RURAL ILEC AREAS IN QUESTION. DO YOU AGREE WITH HIS OBSERVATION AND CONCLUSION?

A. No. Mr. Brown (pp. 25, 45) makes the superficial observation that USCOC is already providing wireless services in the rural ILEC areas in which it requests CETC designation and concludes that USCOC's ETC designation is therefore not in the public interest. In Alaska, Mr. Brown opposed an ETC petitioner for the opposite, and equally invalid reason, that the petitioner had not constructed enough facilities to credibly demonstrate its capability.[25]

There is no dispute that USCOC is currently providing *some* services in *some* of the areas served by rural ILECs in Missouri, but that fact has no bearing on this proceeding. USCOC is making a commitment (or more accurately, seeking the ability to make a commitment) to provide the supported services throughout these service areas in direct competition with the rural ILECs; something that, without USF support, it could not do. Mr. Brown states (p. 25), "Wireless carriers, including USCOC, have built facilities throughout rural America, including rural areas in Missouri." It is certainly true that USCOC has made substantial investments in its Missouri network, and provides coverage throughout several areas. Consistent with the stated intent of the Act, USCOC now seeks to commit to offer supported universal services throughout these areas with a wireless service at a level of quality that can compete directly with the current wireline local service offerings. That incremental step requires access to USF support, just as access to that support was necessary for the rural ILECs to make the same commitment.

An understanding of why Mr. Brown's analysis fails requires a more substantive look at how the rural ILECs originally entered these markets and how competitive

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[25] *Order No. 10 in Docket No. U-02-39*, Regulatory Commission of Alaska, August 28, 2003, approving the application of Alaska DigiTel, LLC for ETC designation.

carriers seek to do so now. Rural ILECs did not begin by providing service with a network whose reach extended throughout their current service areas; they began by constructing facilities where it was economically feasible to construct without support and then expanding those facilities over time – *while receiving implicit or explicit universal service support*. At no time was that support withheld because the rural ILEC was "already providing" wireline service in some part of these areas. Mr. Brown acts as if the existing rural ILEC networks sprang forth from the head of Zeus in their current form and with their current geographic coverage. This did not happen: rural ILECs expanded and upgraded their wireline networks over time while receiving support. The opportunity to do likewise is all USCOC is requesting.

The entry and expansion of a wireless carrier such as USCOC is not fundamentally different. USCOC can and does provide services throughout much of the area for which it seeks ETC designation. ETC designation will enable USCOC to take the next step and offer the supported services throughout these areas in direct competition with the ILECs' wireline services. Network buildout will improve service quality and coverage to the point that rural consumers may find wireless service to be an alternative for the rural ILEC's wireline service. Such an outcome is fully consistent with the stated objectives of the Act.

Mr. Brown's Argument That USCOC Should Not Be Designated As An ETC Because It IS NOT Already Providing Service In Rural Areas Is Based On A Misunderstanding Of The Federal USF Mechanism

Q. MR. BROWN ARGUES THAT USCOC REQUEST FOR ETC DESIGNATION SHOULD BE DENIED BECAUSE USCOC IS *NOT* PROVIDING SERVICE IN THE RURAL ILEC AREAS IN QUESTION. DO YOU AGREE WITH HIS OBSERVATION AND CONCLUSION?

A. No, and I am still dizzy from the head snap that was required to follow Mr. Brown's 180 degree change in position. After arguing that USCOC should not be designated as an ETC *because it is already serving the rural ILEC areas at issue*, Mr. Brown turns around and argues that USCOC should not be designated as an ETC *because it is not serving 100% of the rural ILEC areas.*

Mr. Brown (pp. 25-41) and Mr. Schoonmaker (pp. 59-73) both devote significant portions of their testimony to a discussion of their understanding of USCOC's current network configuration and what they claim to have been USCOC's deployment strategy to date. Their conclusions do not follow for several reasons.

Mr. Brown first takes issue with USCOC's buildout strategy, and suggests that USCOC invested in the more densely populated areas (or areas of more dense potential usage) of its licensed area first, before building out into less dense areas. Of course they did; any other entry strategy would be irrational and financially irresponsible. Without support, the only place a rational carrier would invest are the lowest-cost, highest revenue areas. Mr. Brown fails to mention that the rural ILECs built out their networks, over time, in exactly the same way: they began with construction where the most people were, and expanded outward from that point. The key distinction between ILEC network expansion and USCOC's buildout to date is that the ILECs made their investments while receiving USF support (either implicitly or explicitly).

USCOC now seeks to expand its geographic coverage and reinforce its service quality to bring people in rural areas service that is comparable to that which is available in urban areas. This is the investment that is made possible, whether the carrier is an incumbent ETC or CETC, through USF support.

The ILEC witnesses next take issue with what they attempt to forecast as USCOC's current level of service quality and availability to customers in the most remote areas of the ILEC service territories. Mr. Brown discusses his understanding of the current location of USCOC towers, the location of rural customers in relation to these towers, and (based on his analysis) the service quality they can expect to receive. He argues (p. 28) that "The actual wireless coverage that consumers experience should be a key factor in the cost/benefit analysis that lies at the heart of the public interest evaluation process." In a sense he is right, but not in the way that he asserts. The fact that customers in some rural areas are not currently able to utilize quality wireless service is a compelling reason that USCOC's Application *is* in the public interest.

Mr. Brown then raises the issue of certain "dead spots" in USCOC's existing coverage that are created by geographic features of the landscape. Setting aside the issue of whether Mr. Brown's analysis is accurate, its results are not relevant. The FCC has clarified that the existence of such dead spots did not preclude the FCC from designating Virginia Cellular as an ETC.[26] If a consumer wants service in a dead spot, it will be up to USCOC to provision it.

Q. DOES A REQUIREMENT TO LITERALLY "SERVE THROUGHOUT A GIVEN AREA," RATHER THAN A REQUIREMENT "TO MEET REASONABLE REQUESTS FOR SERVICE," MAKE TECHNICAL SENSE?

A. No. In the case of an application by a wireless carrier for ETC designation, the application of this requirement must reflect the important distinctions in how wireless and wireline carriers provide service to customers. Wireline carriers, due to the technical

[26] *Virginia Cellular Order*, ¶ 23.

constraints of their networks, offer service not to a *customer*, but to a fixed *customer location*. The wireline carrier's customer can only utilize the service at the designated location, because that is where the ILEC's wires end. In direct contrast, a wireless carrier offers service not to a *customer location*, but to a *customer*. The customer can use the service at multiple locations throughout the service area.

Mr. Schoonmaker asserts (p. 57) that "U. S. Cellular's burden is to demonstrate that it will provide the supported services throughout the service areas for each separate ILEC study area." This, of course, is not actually the standard and the FCC has never interpreted a CETC's service obligation in this manner. Instead, the FCC has consistently referred to a potential ETC's commitment to meet "all reasonable requests for service."[27] As set forth in USCOC's Application, the company has agreed to adopt the same checklist that was approved by the FCC in the *Virginia Cellular Order*. This checklist provides a step-by-step means of providing service to customers who do not currently receive coverage at their home or business location.

Mr. Schoonmaker goes on to conclude that "to the extent that [U. S. Cellular's] signal coverage is not adequate, that would clearly be a negative factor in the public interest test for receiving that [ETC] designation." I suggest that Mr. Schoonmaker has it exactly backwards: limitations in signal coverage underscore the need for high cost USF

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[27] Mr. Schoonmaker is a bit schizophrenic on this issue. At p. 32, he correctly notes that an ETC's obligation is to provide service "upon a reasonable request." At p. 6, footnote 1, however, Mr. Schoonmaker notes that USCOC has made such a commitment to provide service to customers "upon reasonable request," and suggests that USCOC has somehow improperly limited its commitment. In reality, USCOC's commitment is directly in line with the federal standard (as Mr. Schoonmaker later admits). This kind of "argument by innuendo" adds little to the record in this proceeding.

support in order to build out network facilities into these areas. Mr. Schoonmaker assumes that the areas in which USCOC does not currently have complete signal coverage are in are the remote and sparsely populated areas of its proposed ETC service area. If his assumption is correct, further investment by USCOC in these areas as an ETC is clearly in the public interest: these are the areas for which federal high-cost funding was designed.

In order to apply the kind of requirement the ILECs suggest, it is necessary to determine what is meant by the idea of "serving" the area. If "serve" is defined as the ability to provide telecommunications service to a customer with minimal buildout of network facilities, then the area actually being "served" by the ILECs includes only the portions of the total service area over which wires have been strung. A wireline network offers actual service to only a small percentage of the area in question. If "serve" is more narrowly defined as the ability to provide telecommunications service to a customer without the construction of any new network facilities, i.e. those locations over which over which wires have been strung and at which a drop wire has been installed so that the customer can physically attach his or her telephone to the network, then the area of ILEC "service" is truly miniscule in comparison to the service area of USCOC. In my experience, rural ILECs likely "serve" between 1% and 5% of their actual study area based on this definition. The potential for a wireless carrier to serve the entire ILEC study area far exceeds that of the wireline ILEC. This broader coverage potential by a wireless carrier has a number of public benefits, including convenience and health and safety benefits.

In the hypothetical case of an application by a wireless carrier that has signal coverage throughout most, but not all, of the service area in question, there are two possible interpretations of this requirement. If the requirement is for an ETC to provide the supported services to *any customer*, then both the wireline and wireless carriers comply: both carriers can and will provide service to any customer that requests it. If the requirement is for the ETC to provide the supported services at *any customer location*, then both carriers fail (though by varying degrees): the wireless carrier can provide service to most of, but less than 100% of, the service area (due to gaps in coverage and/or so-called dead spots), while the wireline carrier can offer service to only a very small fraction – almost always less than 5% – of the service area.[28] Clearly, the potential for a wireless carrier such as USCOC to "offer service throughout its designated ETC service area" far exceeds that of any wireline ILEC.

Recognition of this key distinction between how wireline and wireless carriers provide service is important. A customer who subscribes to a wireline carrier's service presumably does so because he can use the service at the location most important to him: his home or business. In contrast, a customer who subscribes to a wireless carrier's service presumably does so because the customer can use the service at the locations most important: locations that may include a home or business but may also include isolated areas and country roads. It is fully consistent with a "public interest" determination to permit these customers to make this choice based on their own needs and preferences.

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[28] In this case, the area where the ILEC can actually offer service is represented by the locations of Network Interface Devices, or NIDs, at the end of wires.

The Commission should also take note that the proposed requirement, if adopted in a competitively neutral fashion, would disqualify the rural ILECs as ETCs. As explained above, no ILEC can "serve throughout the entirety of [its] ETC designation area;" it can provide service only to a very small percentage of this area (the area at the end of a transmission wire). Service coverage by wireline carriers can *never* meet the ILEC standard, and it would be unreasonable for the Commission to require the ILECs to provide a specific timeframe within which they would be able to extend their networks to provide service throughout the entirety of their service area.

Q. YOU HAVE SUGGESTED THAT IT IS IMPORTANT TO RECOGNIZE THE FACT THAT WIRELESS SERVICE CAN BE USED AT MULTIPLE LOCATIONS WITHIN A SERVICE AREA, WHILE WIRELINE SERVICE CANNOT. IS IT YOUR UNDERSTANDING THAT MOBILITY IS A SUPPORTED SERVICE FUNCTIONALITY?

A. No. Even though Mr. Brown correctly notes (p. 36) that it is part of the public interest analysis, both he and Mr. Schoonmaker fail to account for its significance. Wireless service has public health and safety benefits (benefits to the consumer that wireline service can never provide) that should not be ignored. The FCC explicitly considered mobility in its public interest findings in both the *Virginia Cellular Order* and *Highland Cellular Order*:

> We find that the designation of Virginia Cellular as an ETC in certain areas served by rural telephone companies serves the public interest and furthers the goal of universal service by providing greater mobility...to consumers in rural and high cost areas.[29]

> The mobility of Highland Cellular's wireless service will provide other benefits to consumers. For example, the mobility of

[29] *Virginia Cellular Order*, ¶ 12.

> telecommunications assists consumers in rural areas who often must drive significant distances to places of employment, stores, schools, and other critical community locations. In addition, the availability of a wireless universal service offering provides access to emergency services that can mitigate the unique risks of geographic isolation associated with living in rural communities.[30]

Based on these important factors, it doesn't make sense to deny ETC designation to a wireless carrier that will provide the supported services to any requesting customer and to nearly all possible customer locations, while granting ETC designation to a wireline carrier that while providing service to any customer, can do so only at a small fraction of potential customer locations.

It is also important to note at this point that the existence of service functionalities beyond the nine minimum functionality requirements in no way disqualifies the carrier's services from the federal universal service program. In the examples above, the FCC found that services offered by a wireless ETC that include an additional functionality – in this case mobility – represents an important customer benefit fully consistent with both the letter and spirit of the federal requirements and the public interest.

Q. MR. BROWN SUGGESTS THAT USCOC HAS AN INCENTIVE TO AVOID THE EXTENSION OF SERVICE INTO MORE REMOTE, HIGH COST AREAS. DO YOU AGREE?

A. No. Specifically, Mr. Brown's theory is that there is some financial incentive for a CETC to serve only low cost areas. He argues (p. 49) that "it is highly likely that the carrier will not build facilities to serve the remote customers, and that the scarce high-cost funds will provide a windfall to carriers service predominantly low-cost markets." What he implies

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[30] *Highland Cellular Order*, ¶ 23.

is that each of the carrier's customers in a relatively low cost area will be free of expenses and will require no further network expenditure, becoming what he has previously referred before the South Dakota Commission as "cash cows."[31]

This is nonsense for several reasons. First, as discussed above, tower construction is not the only means of extending service coverage into high cost areas. Second, a CETC cannot serve only low cost customers and receive high cost support; if support has been properly disaggregated pursuant to 47 C.F.R. §54.315, a CETC will receive high cost support only when it serves high cost customers, and will receive low cost (or no) support when it serves a customer in a low cost area. The arbitrage opportunity envisioned by Mr. Brown is a fantasy: high cost support is received when an ETC (whether an ILEC or a CETC) serves a high cost customer. Third, the ILECs have not shown why their existing customers should not also be characterized as "cash cows." Pursuant to Mr. Brown's theory, each ILEC must show that it has made an incremental investment in new network facilities to serve new customers that is equal to the amount of federal USF received. Any ILEC that has not done so would be guilty of an improper use of these funds. Fourth, because the amount of per-line support is higher in high cost areas (assuming that support has been properly disaggregated in order to reflect variations in cost levels) CETCs have an equal incentive to serve both high and low cost areas. Finally, Mr. Brown's entire premise that USCOC lacks "an enforceable commitment" to make the necessary investments to expand service is faulty. This Commission and FCC regulations provide the "enforceable commitment" suggested by Mr. Brown.

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[31] In the Matter of the Filing by WWC Holding Co., Inc, d/b/a CellularOne® for Designation as An Eligible Telecommunications Carrier in Other Rural Areas, Docket No. TC03-191, p. 6.

Q. HAS USCOC ALSO MADE A COMMITMENT TO RESPOND TO ALL REASONABLE REQUESTS FOR SERVICE?

A. Yes. It has committed to follow the steps previously adopted by the FCC for responding to these requests.

Q. HAS USCOC MADE A COMMITMENT TO BUILD OUT FACILITIES THROUGHOUT THE AREA IT IS DESIGNATED FOR?

A. Yes. USCOC has committed to build out 16 new towers within the first 18 months following its designation with the initial support it receives. This Commission has authority to require USCOC to account for all support it receives, to ensure that support is being used to benefit Missouri's rural consumers.

Mr. Brown's Argument That USCOC Should Not Be Designated As An ETC Because It Will Lead To A Flood Of Petitions Is Neither Relevant Nor Correct

Q. MR. BROWN SUGGESTS (P. 20) THAT USCOC SHOULD NOT BE DESIGNATED AS AN ETC BECAUSE OTHER CARRIERS WILL THEN HAVE NO CHOICE BUT TO SEEK SUCH A DESIGNATION. IS HE RIGHT?

A. No. At page 20, Mr. Brown argues that all other wireless carriers in Missouri "will also apply for and receive approval of ETC status as well." He goes on to explain that all wireless carriers in Missouri would receive funding and that "the federal USF … could go up by as much as $81.1 million per year." His conclusion is inconsistent with both experience in other states and with basic economics.

As an initial matter, experience shows that the designation of a wireless carrier as an ETC in a given geographic area has not resulted in a flood of petitions. There are some fundamental economic reasons why this result is not unexpected. First, wireless

carriers may choose as their business plan to provide certain services in certain areas without making a commitment to offer supported services as a viable competitive alternative throughout the ILEC service area. Numerous carriers across the country have clearly chosen this route.

Second, a rational carrier will not be indifferent to whether a CETC has already been designated in a given service area, but will factor that information into its business case. A carrier considering entry as an ETC into an area must consider the market share that it expects to capture (based on the number of providers already present), the resulting unit costs to serve the area, and the amount of support available. Because market share and the resulting number of subscribers is a primary driver of unit costs (particularly for wireless carriers), the existing mechanism is self-regulating to a significant degree: the first carrier seeking ETC designation may find that entry into the area makes good business sense, but the next carrier (as a potential ETC) is less likely to find the area economically viable. The likelihood that a given carrier will seek ETC designation diminishes as additional ETCs are designated: the market can be expected to limit the number of ETCs to the number that can be viable given the rural ILECs' cost structure. Of course, the answer may be one, in which case no carrier would seek CETC status and the incumbent would remain a monopoly provider.

Finally, Mr. Brown has no basis to speculate and prejudge the outcome that any other ETC applicant will automatically "receive approval of ETC status" from the Commission.

ILEC Assertions That Rural Areas Are Often More Costly To Serve Than Urban Areas Is Not In

Dispute And Unrelated To Issues In This Proceeding

Q. MR. BROWN MAKES VARIOUS ASSERTIONS REGARDING THE COST TO SERVE CUSTOMERS IN DIFFERENT GEOGRAPHIC AREAS. ARE HIS CONCLUSIONS CORRECT?

A. Mr. Brown presents various cost information that he asserts supports a recommendation to deny USCOC's request for ETC designation. Upon taking a closer look, however, it becomes evident that Mr. Brown's cost analysis is based on a fundamental misunderstanding about (1) how network costs vary on a geographic basis and (2) how the cost models he relies upon actually work.

Mr. Brown's Argument That The Designation Of A CETC Will Result In Network Inefficiency Is Based On Unreliable Data, Faulty Short-Term Reasoning, And Poor Economics

Q. MR. BROWN ARGUES (P. 19) THAT DESIGNATING A COMPETITOR OF AN ILEC AS AN ETC WILL INCREASE ILEC COSTS BY CREATING A "LOSS IN NETWORK EFFICIENCY." PLEASE EXPLAIN YOUR UNDERSTANDING OF THIS ARGUMENT.

A. Mr. Brown makes this claim (p. 22) by asserting that "when multiple providers serve the same sparsely populated area, the cost for both providers increases," but ultimately provides no factual basis except for "illustrative" charts and a mismatch of cost and customer density data.[32]

[32] Mr. Schoonmaker appears to simply be a Brown disciple on this matter. Like Mr. Brown, he claims (p. 54) that "since costs of a telecommunications network are relatively fixed, the splitting of a rural market between two or more providers generally causes the cost of service to increase for each of the providers on a per customer basis." Mr. Schoonmaker has relied upon Mr. Brown's framework and data in this and other proceedings (See Illinois Corporation Commission Docket No. 04-0653). Because Mr. Schoonmaker's testimony offers no new information, I will focus on Mr. Brown's more complete (though flawed) testimony.

There are at least four reasons why Mr. Brown's claims of network inefficiencies should be dismissed.[33] First, Mr. Brown's imprecision at this initial stage creates a problem for his analysis. In order to properly analyze the behavior of these costs, it is essential to define and consider each of the variables in a consistent manner. Without more specificity, the variables "fixed costs" and "sparsely populated" have no real meaning and require further definition, but Mr. Brown's analysis proves to be long on generalities and short on the needed precision. Second, Mr. Brown's assumption that household density, measured at the level of the ILEC wire center or entire ILEC service area, can accurately predict network costs is not supported by the facts. Third, Mr. Brown relies on flawed output from the Benchmark Cost Proxy Model, version 3.0, as the sole factual support for his arguments. Finally, Mr. Brown averages these results in a way that renders them meaningless.

Q. PLEASE EXPLAIN THE PROBLEMS CREATED BY MR. BROWN'S FAILURE TO DEFINE HIS VARIABLES WITH THE NECESSARY DEGREE OF PRECISION.

A. Mr. Brown refers to "fixed" network costs, but fails to state a geographic or time dimension for this assumption. This is important. There are essentially no costs that are fixed at the level of the entire network. In other words, apart from some high-level administrative functions, there are no costs that are avoidable only if the entire network is eliminated. Fixed costs do exist at the level of discrete network facilities (the common

[33] For the reasons described in above, Mr. Brown's arguments are also irrelevant to the question before the Commission in this proceeding. Mr. Brown is simply re-arguing issues that were fully considered by the FCC when developing the federal universal service mechanism currently in effect. In this section of my testimony, I will endeavor to explain why, even if they were relevant, Mr. Brown's conclusions regarding network costs are invalid and unsupported.

cards in a digital loop carrier remote terminal, for example), and scale economies do exist at this level of disaggregation. Mr. Brown focuses his analysis of network costs and line density at a relatively high level (the level of an entire wire center, MSA/RSA, or very high level of the ILEC service area), but insight into how costs differ among different geographic areas can only be gained if the analysis is conducted at a much more discrete level.

Q. PLEASE DESCRIBE THE PROBLEMS CAUSED BY MR. BROWN'S ASSUMPTIONS REGARDING THE RELATIONSHIP BETWEEN HOUSEHOLD DENSITY AT THESE HIGH LEVELS AND PER-LINE NETWORK COSTS.

A. Mr. Brown builds his entire argument on the unstated assumption that the density of households, at the relatively aggregated level of a wire center or ILEC service area, can be used to accurately predict per-line network costs in rural areas. This is an unsupported yet critical assumption that has not historically been shared by the Rural Task Force, the Joint Board, or the FCC. By extension, Mr. Brown is arguing that fixed network costs exist at these levels of geographic aggregation, and that scale economies will be lost if the incumbent rural LEC fails to serve all of the customers within that geographic area. This assumption is also not supported.

Mr. Brown's errors of fact can be grouped into the following three areas.

1. Mr. Brown assumes that the number of households per square mile, *as averaged at a relatively high geographic level*, is a reliable predictor of network costs in that geographic area. This assumption is essential to his conclusions and warrants a closer examination.

To be clear, I am not suggesting that line density is not a driver of network costs; this is the case in almost all geographic areas. The problem relates to the level of geographic aggregation of the density data. Mr. Brown has previously recognized the potential for this problem: "a simple, but misleading, measurement of density can be performed by dividing the number of lines a company serves by the area of its serving territory. This would be misleading, since the cost of providing service is strongly influenced by the presence or absence of 'clustering' of customers."[34] This observation is certainly valid; the average density over a given geographic area has almost no bearing on network costs if that geographic area is too large to capture the characteristics that constrain network design. Mr. Brown's general observation regarding the distribution of customers is correct, but his idea and his data source are a complete mismatch. Within the geographic area being studied, both the overall density and the distribution of customers are important to an understanding of network costs. For example, consider two hypothetical areas, both 10 square miles in size containing 50 customer locations. In scenario A, the customer locations are evenly distributed throughout the entire area. In scenario B, 90% of the customers are clustered together in a relatively small portion of the area, while the remaining 10% are evenly distributed. All else equal, scenario A will require more investment to serve than scenario B; but in both scenarios the overall customer density is 5 customers per square mile.

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[34] *See* McLean & Brown's June 25, 2002 white paper *USF Portability – Getting it Right*, p. 6. Oddly enough, Mr. Brown chose not to share this observation with his clients in this proceeding: each of them reports customer density on exactly the basis that Mr. Brown describes as "simple, but misleading."

Mr. Brown states that "a given number of customers uniformly distributed over the serving area would have very different cost characteristics from a situation where the same serving area had most customers densely clustered in a town, with only a few scattered through the surrounding area."[35] The problem stems from Mr. Brown's choice of geographic units to study in this proceeding; none of these geographic units accurately capture the effects of the clustering he describes.

The distribution of customer locations throughout the geographic unit of study is important, but when considered at the level of these high level geographic areas the reality is the opposite of Mr. Brown's assumption. *Customers are far more likely to be uniformly distributed throughout the area represented by non-rural areas of analysis, and far more likely to be clustered in the area represented by rural areas of analysis.* High-density areas are characterized by city blocks, and moderately high-density areas may encompass small towns, subdivisions, and similar planned suburban developments. Households are roughly evenly distributed in each of the examples that Mr. Brown used as support for his analysis. In contrast, rural areas (whether wire centers or entire ILEC study areas) may encompass crossroads, small unincorporated townships, and significant unpopulated areas within their borders.[36] Households are not evenly distributed in these examples, but tend to be clustered. As the area being studied becomes larger in size and as population density decreases (as is typical in rural areas), it becomes significantly *less* likely that the average number of households per square mile for the entire area will be a meaningful approximation of the average number of households per square mile *in the*

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[35] *Id.*

[36] An area in which most customers are located in the town, with the remaining customers widely spread out, for example.

area in which telephone plant must be built. Mr. Brown has this relationship exactly backwards: he has incorrectly assumed the existence of a correlation between population density and the average per-line investment that must be made to provide telephone service to the people living in that area.

A key fact, consistently overlooked by Mr. Brown in his analysis, is that the area that must be served via telephone plant is determined not by the size of a given wire center (and certainly not be the entire ILEC study area), but by the distribution of customers within that area. In those areas within which customers are evenly distributed (primarily urban and suburban areas), the area to be served may be as large as the entire area being studied. In areas in which customers are more clustered, the area to be served is smaller than the total area being studied, and often significantly smaller. Mr. Brown makes two fundamental errors: (1) he focuses on the average customer density of an area while ignoring the cost implications of customer clustering (the same clustering he previously stressed as necessary to avoid a "misleading" result), and (2) he justifies this omission by assuming – incorrectly – that customer clustering is more likely to be evident in an urban area than a rural area.

In Chart II (p. 21), Mr. Brown focuses on households per square mile in his analysis. This information is meaningful if, *but only if*, there is a demonstrable correlation between population density *as measured at the level of the total wire center area* and ILEC average per-line investment. As described above, no such correlation exists.

Ultimately, Mr. Brown has offered nothing in his testimony to demonstrate the existence of such a correlation beyond his unsubstantiated – and incorrect – assumption.

As a result, Mr. Brown's example provides only the appearance of useful information; it offers no insight into how network costs actually are incurred by these rural ILECs and is overtly misleading.

Mr. Brown's assumption of a direct relationship between household density and per-line costs to serve the area has also been heard and rejected by the FCC. The Rural Task Force argued to the FCC that the cost proxy models being considered understate the relevant geographic area to be studied. The FCC rejected this argument, noting that these models properly focused on the smaller areas in which customers are actually located, and not the larger areas that are both "served and unserved, where the unserved can be lakes, mountains, deserts...the Rural Task Force's area will always be greater than the model reported area."[37] This distinction is important. Mr. Brown considers the household density of this larger area in his analysis, but the area of the smaller "served" area is the relevant variable for the determination of network costs. By definition, the density of the served area will always be, as the FCC correctly recognized, higher than the area of the "served" and "unserved" areas combined.

2. Mr. Brown implicitly assumes that the results of the Benchmark Cost Proxy Model ("BCPM") reports costs on a "households per square mile" basis that is comparable to wire center-level or MSA/RSA-level information. This fundamental misunderstanding of how the BCPM cost model works and, by extension, how to properly interpret the results, causes Mr. Brown to go far astray. At page 21, he presents Chart II that includes per-line cost entries for all ILECs in the State of Missouri at different numbers of households per square mile, and presumably intends that at least

[37] *Fourteenth Report and Order*, ¶ 175 and footnote 412.

some of these areas represent a meaningful description of the characteristics of the rural ILEC areas for which USCOC seeks ETC designation.

What Mr. Brown fails to point out is that the cost proxy model he relies upon actually reports density zones in the form of "lines per square mile of the area to which telephone plant is actually built."[38] This area is always different, and almost always much smaller, than the area of the wire centers in question. *As a result, Mr. Brown's analysis systematically* ***understates*** *the relevant density of the area being served, and* ***overstates*** *the cost per line to serve the area.*[39]

3. Mr. Brown implicitly assumes that all telephone plant is engineered at the level of the wire center. As a result, his analysis assumes that the average investment is a function of the population density of one, and only one, of these areas of analysis (with no regard to the population density of neighboring areas or the location of customers within those areas). When this constraint is relaxed, additional insight is gained into why the area in which telephone plant is built has density characteristics different from (and typically much greater than) the average density of a given wire center.

Bringing it all together, Mr. Brown suggests that the costs of rural ILECs can be understood by analyzing the density of the ILECs' lines (or households as a proxy for those lines) that serve customers in a relatively large geographic area. He further assumes that a meaningful weighted-average cost per line can be developed for Missouri

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[38] For BCPM, the results are more accurately described as "housing units per square mile, as measured at the level of the area actually served by telephone plant, as defined by the assumed distribution area created by the model based on the aggregation of up to sixteen microgrids into an ultimate grid."

[39] Of course, if the cost model itself overstates cost for a given density zone, Mr. Brown's analysis deviates even further from reality.

by averaging the results of all ILECs in the State. This information, combined with the flawed cost results (I will described the flaws in this information next in my testimony) yields, according to Mr. Brown, a *demonstration* of the unique vulnerability of rural ILECs to competitive entry. In reality, there is no reason to assume that the line density of an entire wire center or is a reasonable predictor of the characteristics of the more discrete geographic areas to which telephone plant is designed, and no reason to assume that the cost results Mr. Brown relies upon are an accurate portrayal of anything whatsoever.

Mr. Brown's Charts Are Overtly Misleading And Provide No Accurate Or Useful Information

Q. PLEASE EXPLAIN WHY MR. BROWN'S RELIANCE ON THE RESULTS OF BENCHMARK COST PROXY MODEL IS MISPLACED.

A. Mr. Brown relies exclusively on the results generated by the Benchmark Cost Proxy Model, version 3.0 ("BCPM"). These results are reported (with no qualifying remarks) in Chart II (p. 21), and reproduced (with some distortion) in Chart III (p. 23). This information serves as the foundation for Mr. Brown's entire argument, and he offers no corroborating data source. If this information is unreliable, his arguments have no factual foundation.

There are, unfortunately, numerous problems with both the BCPM results relied upon by Mr. Brown and with his presentation of that information. First, Chart II significantly distorts the results. The x (horizontal) axis of Chart II varies in scale. At the left side of the chart, a given horizontal distance represents a change of 10 households, while at the right side of the chart, that same distance represents a change of 90,000 households. This dramatic change of scale (not noted on the chart) distorts the

shape of the curve and causes it to appear to slope upward at a misleading location. Chart III retains this dramatic change of scale, but omits all units (both households and dollars) on both axes, creating an overtly misleading representation of how BCPM 3.0 reports that costs vary. Exhibit DJW-2 reproduces Chart III without the distortion in scale. This corrected chart shows that, at least according to the BCPM, per-line network costs actually vary very little across a wide range of population densities, especially when per-line costs are averaged across a geographic area.

The scale on Chart II (deftly omitted from Mr. Brown's Chart III) suggests that Mr. Brown intended to use a logarithmic rather than linear scale. If this is the case, the same conclusion holds: his charts distort the BCPM results. Exhibit DJW-3 shows a corrected Chart III using Mr. Brown's data points and a logarithmic scale. If it was Mr. Brown's intent to present this information using a logarithmic scale, an additional problem is created. Mr. Brown has offered no rationale for his conclusion that the use of a non-linear scale would provide a more accurate visual representation of the BCPM results that he relies upon. By all appearances, the linear scale provides a more accurate representation of how BCPM reports that costs vary across density zones.

Even without this distortion in his presentation, Mr. Brown has two other problems with his BCPM results. First, this version of BCPM has a number of well-documented errors that cause it to overstate the necessary investment in network facilities, especially in areas of low line density. For example, this version of the BCPM overbuilds sub-feeder facilities, thereby significantly overstating the number of route miles of cable required. The calculated investment in these network facilities is also a direct function of the user-defined inputs to the model. Although he did not specify, in

other ETC proceedings Mr. Brown has used "FCC Common Inputs" to populate the BCPM. What he has done here is unclear; the set of common inputs adopted by the FCC is for use in the Hybrid Cost Proxy Model ("HCPM") and is not the same format as this version of the BCPM. Some judgment calls are necessary in order to convert the inputs from one format to the other. If BCPM default values were used for some inputs (as would almost certainly have to be done in this case), the reported results are certainly too high. The sponsors of BCPM 3.0 have readily admitted that if default inputs are used in the model results will be overstated. Finally, BCPM 3.0 also commits an error that should be familiar to Mr. Brown: it assumes that telephone plant cannot be built across invisible lines on a map. In the case of the BCPM, it assumes that telephone plant cannot cross the boundary of the "grids" that it creates internally when mapping an area. In each case, this false assumption causes network investment and costs to be artificially overstated.

Q. YOU STATED THAT MR. BROWN HAS AVERAGED THE BCPM RESULTS IN A WAY THAT RENDERS THEM MEANINGLESS. PLEASE EXPLAIN WHY THIS IS THE CASE.

A. Mr. Brown reports his BCPM results as a state-wide average of the results for each density zone. Mr. Brown has argued in other proceedings that the BCPM does not produce accurate results at the wire center or study area level – yet these inaccurate values are the ones used by Mr. Brown to calculate his average. Such averaging creates the potential for significant accumulated error. If it could be demonstrated that each of the errors were random in both direction and magnitude, then it is possible – but far from certain – that some of the error might cancel. There is absolutely no evidence that either

of these conditions have been met in this case, though. If in fact the errors are created by a non-random bias, as the best available evidence suggests that they are, the errors accumulate rather than cancel out.[40] The best that can be said is that the BCPM results relied upon by Mr. Brown represent an average of inaccurate values, and that the direction and magnitude of the accumulated error in that average, while almost certainly significant, is unknown.

Q. HOW DOES MR. BROWN UTILIZE THE BCPM RESULTS IN HIS ANALYSIS?

A. Based on this information that is almost certainly inaccurate and that is at best unreliable, Mr. Brown does not hesitate to reach some very specific conclusions regarding the relationship between the density of households and per-line costs in rural areas.

Based on his assumptions about the behavior of network costs, Mr. Brown reaches the conclusion that the "efficiency loss" with the introduction of a second ETC should be measured by calculating the change in unit cost based on his cost curve. Chart III illustrates this proposition. As drawn, Mr. Brown's curve suggests a significant efficiency loss if a given volume of customers is lost to another ETC in a medium to low-density area, and a miniscule efficiency loss if the same number of lines are lost to an ETC in a high-density area.[41] I have no trouble with the basic concept that Mr. Brown

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[40] While it is impossible to determine based on the limited information provided by Mr. Brown, it is entirely possible that he has created a "the cost is $10, plus or minus $20" level of statistical certainty.

[41] Mr. Brown refers to the change from A1 to A2 and from B1 to B2 as "an equivalent reduction in density" (p. 23), apparently forgetting the change in scale on their horizontal axis (Chart III is completely devoid of units). *The reduction shown is not equivalent*, either in terms of absolute units or on a percentage basis. At the end of the day, Mr. Brown's work does drive home one important lesson: don't leave the units off your charts.

seeks to illustrate; an assertion that "in an area in which costs increase at an increasing rate, a given change in volume will result in a greater change in unit costs" is a tautology. My concern is that Mr. Brown apparently is asking (or at least expecting) the Commission to accept that this purely illustrative curve – and the mathematical characteristics it implies – bears some factual relationship to how network costs actually vary with line density in Missouri. There is no basis whatsoever for such a conclusion.

Setting aside the factual inadequacies, Mr. Brown's analysis suffers from a different – and fundamentally more important – problem. His short-term, static analysis ignores important longer-term impacts on efficiency and unit cost. I will assume, purely for the sake of discussion that the curve shown in Mr. Brown's Chart III provides some useful information regarding the per-line network costs that should be incurred to serve areas of varying density.[42] BCPM purports to calculate economic costs; that is, the costs that would be incurred by an efficient provider. These costs are highly unlikely to be representative of the embedded costs of most rural ILECs. Exhibit DJW-4 illustrates, based on a generous assumption regarding the relationship between economic costs and the current level of LEC embedded costs, the relationship between these two cost curves.

In Mr. Brown's short-term, static model, only movement along the cost curve is possible. No shifts in the curve are permitted. When a more meaningful long-term view is considered, the cost curve of a provider can (and should) shift. Such a dynamic model is necessary to capture one of the primary benefits of competition. With no competitive entry, the incumbent rural LEC illustrated by the "embedded cost" curve in Exhibit DJW-

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[42] I cannot overemphasize the point that this curve suffers from numerous factual inaccuracies. Any pretense of brevity prevents them from being fully examined in this testimony.

4 has no incentive to increase its network and operational efficiency. This hypothetical ILEC can waste the entire "weaning period" furnished by the FCC in the *Fourteenth Report and Order,* by sitting back, collecting universal service funding sufficient to recover total embedded costs, and do nothing to prepare for a time when competitive market forces will actually act upon it. This ongoing inefficiency will remain largely hidden (or at least comfortably ignored) as long as no competitor is present.

The entrance of a competitor, even during the period of time in which the rural ILEC is assured of embedded cost recovery, will serve to bring these inefficiencies to light. The prudent ILEC will act now to increase the efficiency of its operation and lower its costs of doing business.[43] The result is a shift of the curve from the embedded level of costs to the economic level of costs as shown in Exhibit DJW-4. Once the public interest model is expanded to include this long-term impact on efficiency, a more meaningful calculation of efficiency loss or gain can be calculated. Assuming again, purely for the sake of simplifying the discussion, that Mr. Brown's cost curve is accurate, it can be readily observed that two forces are acting on unit costs. In the purely short run, unit costs may increase as an inefficient provider provides service to fewer units of demand. Over the longer term, increased efficiency will almost certainly surpass this short-term effect, resulting in a net efficiency gain and a net benefit to the rural consumers of telecommunications services.

Mr. Brown is correct that without competitive entry and the designation of an additional ETC, this short-term change will not occur. It is equally important to

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[43] The imprudent LEC will ultimately face a day of reckoning, but will have squandered the grace period that would have permitted a relatively painless transition.

recognize that without competitive entry and the designation of an additional ETC, this long-term change is likewise unlikely to occur. The transition path chosen by the FCC is not cost-free or even-pain free; it is an explicit trade-off of the interests of incumbent ILECs, potential new entrants, and the consuming public.

"Redefinition" of the ILEC Study Areas Is in the Public Interest

Q. MR. SCHOONMAKER ARGUES THAT USCOC'S REQUESTS FOR SERVICE AREA "REDEFINITION" ARE NOT IN THE PUBLIC INTEREST. DO HIS ARGUMENTS HAVE ANY MERIT?

A. No. At p. 79, Mr. Schoonmaker describes what he believes are the "guidelines or recommendations" available to the MPSC from the Joint Board and FCC. While he purports to be quoting from the Joint Board's recommendation, in reality Mr. Schoonmaker is simply making up language out of whole cloth and doing so in a way that takes language that is neutral (and in no way presumes an answer) and changes it into language that gives the impression that a presumption exists that must be overcome.

As I described at p. 22-23 of my direct testimony, USCOC's proposal for "redefinition" will have no impact on the ILEC's status as rural carriers pursuant to Section 251(f) of the Act and I have yet to see an ILEC suggest, much less demonstrate, that administrative costs will be created. What remains is the question of whether the requested "redefinition" has the potential to increase the likelihood of "creamskimming" by the CETC.

Q. DOES MR. SCHOONMAKER CORRECTLY DEFINE "CREAMSKIMMING"?

A. No. Mr. Schoonmaker asserts (p. 80) that "creamskimming" occurs "where a carrier primarily serves the low-cost and high-revenue customers in a rural telephone company's study area, but receives USF support based on the presumption that it is serving throughout the service area." There are a couple of problems with Mr. Schoonmaker's definition.

First, as addressed previously in my testimony, USF support is unrelated to revenue. High-revenue customers do not generate higher levels of support, and the proportion of high-revenue customers served to the extent the term "high revenue" can be defined and assessed in a meaningful way – has no impact on support received. ILECs do not receive a reduced amount of support to serve a customer that may be "high-revenue."

Second, the presumption is not that the CETC is "serving throughout" the ILEC service area, but rather that there is not a significant disparity in cost between the area served and the area not served.

Q. WILL USCOC'S REQUESTED "REDEFINITION" INCREASE THE LIKELIHOOD THAT "CREAMSKIMMING" WILL OCCUR?

A. No, for multiple reasons.

First, USCOC is seeking designation in all of the identified ILEC's wire centers that are within its FCC-licensed service area. As the FCC has previously concluded, a carrier that proposes to serve throughout its licensed area is not attempting to creamskim.

Second, 47 CFR §54.315 permits ILECs to disaggregate support based on geographic differences in cost. Even Mr. Schoonmaker's definition of "creamskimming" cannot be met if the ILEC takes advantage of this opportunity to disaggregate support.

Third, as described in some detail at pp. 18-19 of my direct testimony, "creamskimming" is a flawed business objective. A carrier contemplating such an entry strategy must be able to identify the ILEC's "low-cost" areas with precision, and, equally importantly, must incur costs in the same way (that is, the entrant's low cost areas must correspond to the ILEC's low cost areas). When comparing the costs of wireless CETCs and wireline ILECs, this is rarely the case.

Finally, the evidence in this case indicates that there is no (to use the FCC's phrase) "great disparity" in costs between areas that would be served by USCOC and areas that would not. After working through his double negative, it appears that Mr. Schoonmaker agrees with this conclusion for at least some of the ILECs: "in regard to BPS, Goodman, Grand River, and Le-Ru, I would agree that the creamskimming analysis does not present substantially convincing evidence that the study areas should not be redefined."[44]

Q. DOES THE CREAMSKIMMING ANALYSIS "PRESENT SUBSTANTIALLY CONVINCING EVIDENCE THAT THE STUDY AREAS SHOULD NOT BE REDEFINED" FOR THE OTHER ILEC STUDY AREAS?

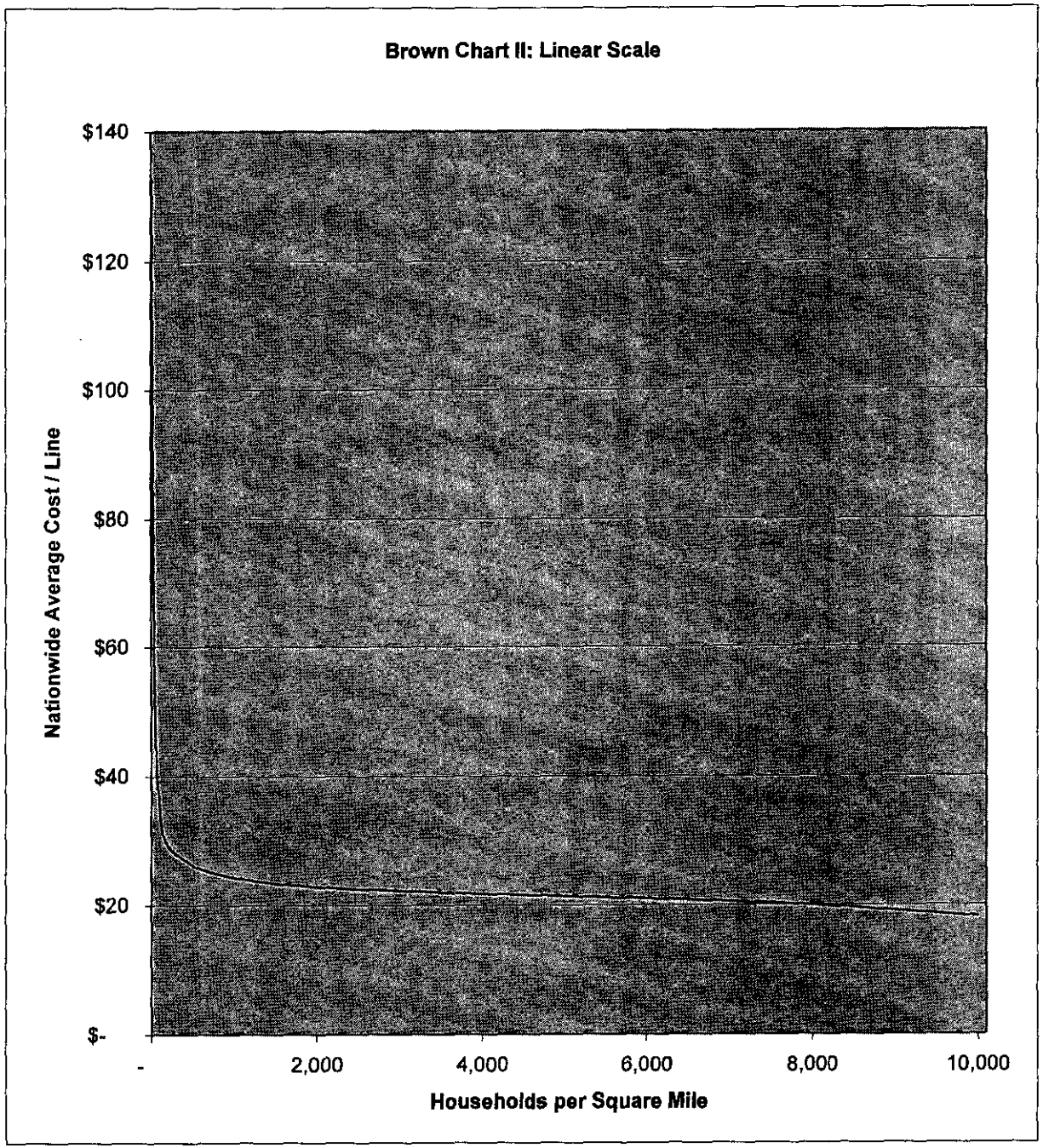
A. No. Mr. Schoonmaker presents no evidence that a "great disparity" in cost exists for any of the remaining ILECs. He argues that "a 25% difference in [population] density" exists for the Mid-Missouri study area, but for the reasons set forth at p. 20 of my direct testimony, a 25% difference in persons per square mile, measured and averaged at the level of the total wire center area, provides no basis for a conclusion that *any* disparity,

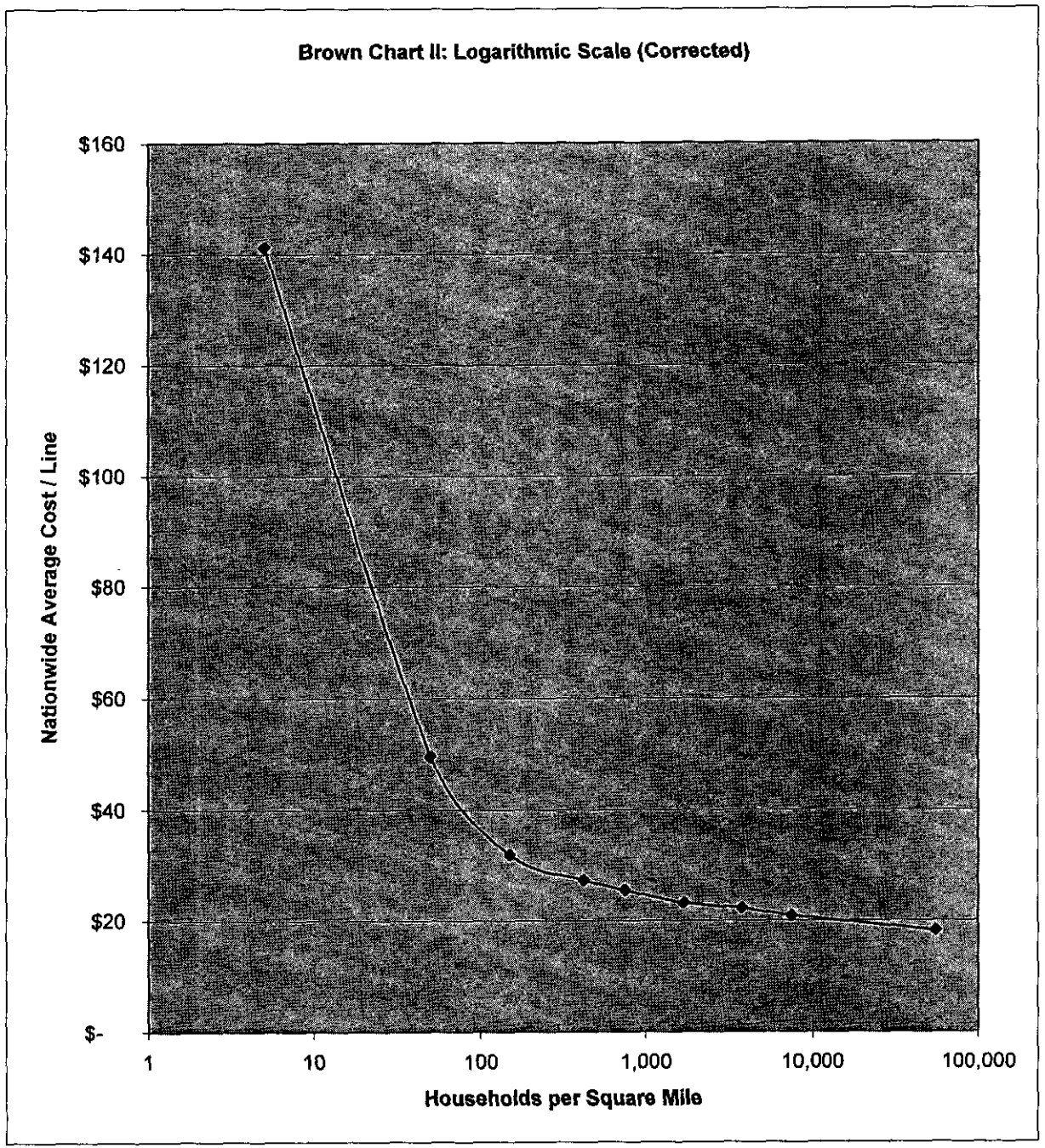
[44] Schoonmaker Rebuttal, p. 82, lines 3-5.

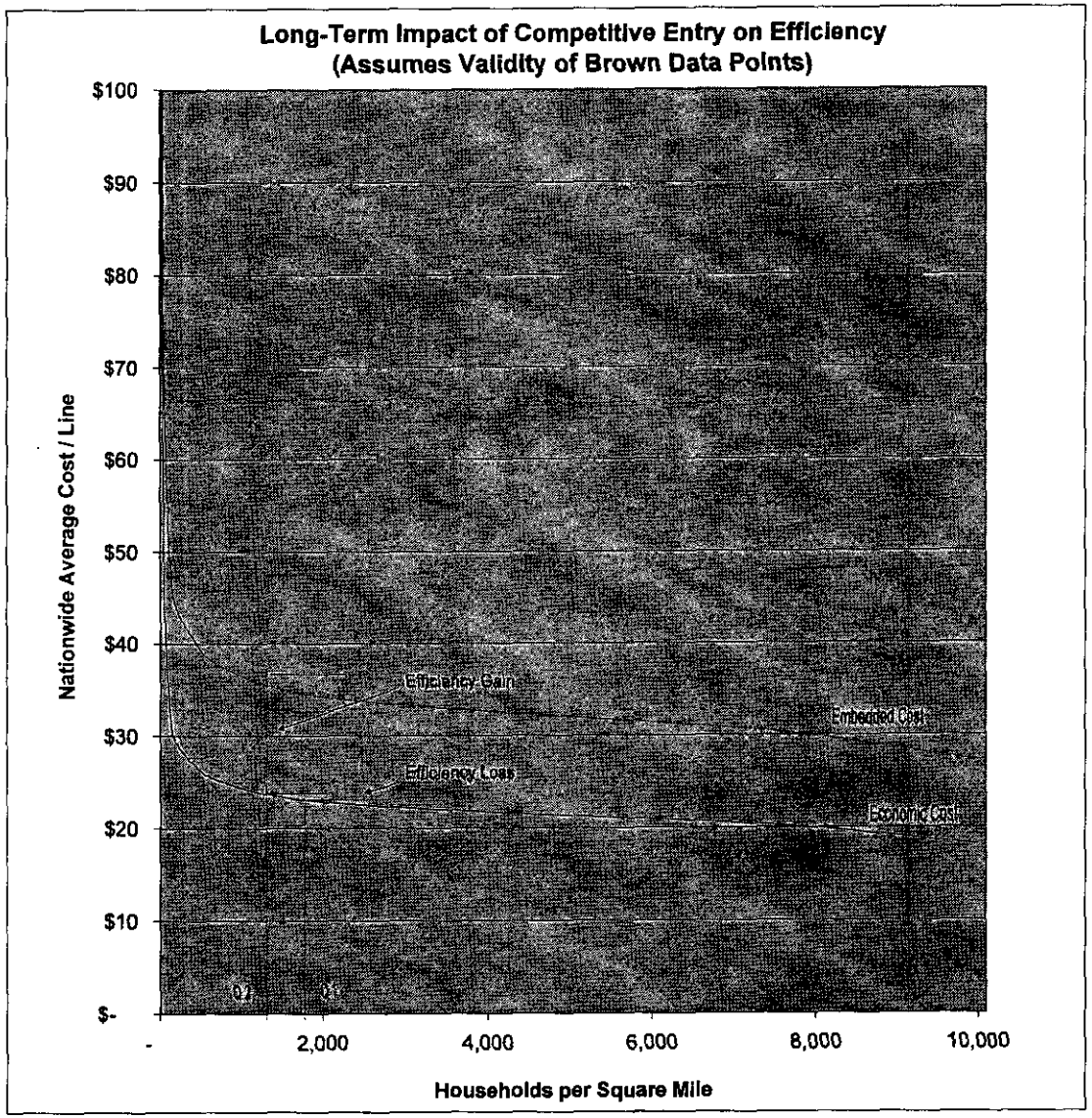
and certainly no basis for a conclusion that a *significant* disparity, exists in the per-line cost to provide wireline service in the subset of the wire center within which telephone plant is actually built. The same conclusion can be made regarding to the Craw-Kan exchanges.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.


Brown Chart II: Linear Scale
$140
$120
$100
$80
$60
$40
$20
$-
Nationwide Average Cost / Line
-
2,000
4,000
6,000
8,000
10,000
Households per Square Mile


Brown Chart II: Logarithmic Scale (Corrected)
$160
$140
$120
$100
$80
$60
$40
$20
$-
Nationwide Average Cost / Line
1
10
100
1,000
10,000
100,000
Households per Square Mile


Long-Term Impact of Competitive Entry on Efficiency
(Assumes Validity of Brown Data Points)
$100
$90
$80
$70
$60
$50
$40
$30
$20
$10
$-
Nationwide Average Cost / Line
Efficiency Gain
Efficiency Loss
Embedded Cost
Economic Cost
D1
D2
-
2,000
4,000
6,000
8,000
10,000
Households per Square Mile