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March 15, 2011

Honorable Howard A. Jack
Administrative Law Judge
New York State Department of Public Service
Three Empire State Plaza
Albany, New York 12223

Re: Case 09-M-0527

Dear Secretary Brilling:

Attached please find the Initial Post-Hearing Brief of Verizon New York Inc.

Respectfully submitted,

Joseph A. Post

Joseph A. Post

cc: Active Party List
Hon. Jaclyn A. Brilling

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding to Examine Issues Related to a Universal Service Fund	**Case 09-M-0527**

INITIAL POST-HEARING BRIEF OF VERIZON NEW YORK INC.

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March 15, 2011

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INTIAL POST-HEARING BRIEF OF
VERIZON NEW YORK INC.

I. INTRODUCTION

The record in this case clearly demonstrates that it is not necessary to establish a universal fund in order to preserve universal service in New York. Robust facilities-based competition exists — and thus alternatives to the services of incumbent LECs are available — in virtually all areas of the State, and the few remaining "white spot" areas where alternative providers are not well established are small and rapidly shrinking. Establishing a fund to guarantee that incumbent providers collect their "revenue requirement" would be — at best — an unnecessary, grossly over-inclusive, and inefficient response to the problem of ensuring the continuity of service in these limited white-spot areas.

Nor is protecting financially troubled telephone companies and their investors from the consequences of competition a sufficient justification for the creation of a universal service fund. As Verizon showed in its testimony, there are alternative measures that the Commission can take in order to protect the financial integrity of troubled incumbent providers. These include retail rate increases (which should not be limited to the current $23 "benchmark" rate for basic services), relief from legacy regulatory obligations, and encouraging the incumbents to evaluate the ways in which they can restructure their businesses and improve their financial situation without compromising functions that are necessary to the maintenance of universal service.

The creation of a fund would not only fail to *advance* the Commission's objective of preserving universal service, it would also have a number of consequences that would actually *undermine* that objective, including the deterrence of competition, the creation of inappropriate incentives for providers seeking funding, and the imposition of unfair burdens on other regulated carriers that face the same financial challenges as the companies seeking funding — and whose financial metrics may be far worse.

Accordingly, there is no justification for creating a new fund to replace the existing Transition Fund ("TF"). The TF was a temporary expedient, not a vested right, and all parties were put on notice that the need for and appropriateness of a successor fund would be evaluated once the TF's initial source of funding was exhausted. That exhaust date is approaching, and the evaluation conducted in this case clearly establishes that no new fund should be created. Even if a successor fund could be justified on policy grounds — and the record of this case shows that it cannot — the Commission has no legal authority to create such a fund.

Despite the overwhelming evidence that a fund would be unnecessary and counterproductive, this brief also sets forth Verizon's recommendations for the administration of a fund, if the Commission should decide to create one.[1] The manner in which a fund is operated should in all respects be consistent with its limited purpose — the maintenance of universal service, rather than the protection of incumbent providers and their investors. Moreover, a fund should be operated in a way that minimizes impacts on competition and the burdens imposed on other service providers. In particular:

[1] Verizon addresses this issue in response to the Administrative Law Judge's procedural rulings, which identify fund operation and administration as issues in this case.

- Funding should be provided to only one company per location, determined through competitive bidding or some similar mechanism. Any viable company that is authorized under law to provide service should be permitted to bid.

- If competitive bidding is not utilized to identify fund recipients, funding should be provided only to the extent necessary to ensure the continuation of universal service, given, among other things, the availability of competitive alternatives. Funding determinations should be based on the assumption that the company seeking funding will raise its retail rates to the maximum just and reasonable level, and that it will take all lawful and reasonably appropriate measures to improve its financial picture while continuing to provide any functions necessary to the maintenance of universal service.

- The Commission should establish an abbreviated annual process for determining whether fund recipients continue to meet the standards for funding. Applicants should have the burden of justifying their requests for funding, and their applications should be subject to strict scrutiny in open proceedings.

- Only regulated service providers should be required to contribute to a fund (as is the case with the Targeted Accessibility Fund, or "TAF"). In particular, commercial mobile radio service ("CMRS") providers and voice-over-Internet-Protocol ("VoIP") providers (whether facilities-based or application-based) should be exempt from any contribution obligation.

- The contribution burden should be allocated among participating providers using a system similar to that currently used for the TAF — in which contributions are based on regulated intrastate revenues — with, however, one important change: The intercarrier-payment offset used to administer the TAF should be eliminated, since it penalizes the provision of facilities-based service, contrary to well-established state and federal policies.

- Any fund that is created should sunset after a period of no more than two years. In order to avoid excessive harm to the contributing companies, total fund payouts per year should be capped at the current size of the TF.

II. OVERVIEW OF THE FUNDING PROPOSALS UNDER CONSIDERATION IN THIS CASE

The funding proposals put forward in this proceeding would not protect universal service itself, but rather a particular, backward-looking and narrow model of universal service — in effect, the universal availability of a particular product (traditional wireline basic telephone service), offered by a particular type of provider, and subject to the same level of regulatory oversight that has prevailed for many decades. But customers are increasingly making a different choice by shifting from traditional standalone POTS service to bundled services offered by unregulated CMRS or VoIP providers. A regulatory model that recognizes the primacy of customer choice should adapt to this new vision of universal service, rather than resist it. Unfortunately, the funding proposals that have been put forward in this case fail to meet that test.

Below, in order to provide a context for the detailed discussion of specific funding issues that follows, we provide a brief overview of the funding proposals put forward by NYSTA, Staff, and AT&T.[2]

A. NYSTA's Proposal

NYSTA proposes to create a new fund that would distribute to incumbent providers[3] an amount equal to their "revenue requirement" as determined in a rate case.[4] All providers, including CMRS and VoIP providers, would be required to contribute to the fund, based on their intrastate revenues. The fund would thus guarantee NYSTA's members a traditionally-determined "reasonable return" on capital — at the expense of the companies contributing to the fund, who by and large would have no such guarantee. A fund recipient's retail rate for basic service would be limited by a basic-service cap, or "benchmark rate," of $15.22 per month — a level that is far below the basic-service rate that the Commission set for Verizon in 2006, despite

[2] CPB also supported the creation of a fund, but provided little detail about what it should look like. In most respects, CPB's recommendations echo the positions of the other pro-fund parties, so our criticisms of those parties' proposals also apply to the CPB proposal.

[3] Since NYSTA would limit access to the fund to carriers that are subject to substantially the same comprehensive regulatory scheme as incumbent LECs (*see, e.g.*, Tr. 51), the intermodal providers who compete in the NYSTA service areas would not be eligible for funding.

[4] *See generally* Tr. 102-03, 106-10 (NYSTA Direct Testimony); Tr. 701-03, 706, 742 (Verizon Rebuttal Testimony).

the fact that NYSTA characterizes its members as “high-cost” providers. Thus, NYSTA’s proposal would ensure that its members’ financial needs would be met in substantial part through fund contributions made by competing providers, rather than through retail rates paid by end-user customers.

NYSTA projects the total size of the fund at roughly $10.3 million per year, although it would not be capped.[5] In fact, NYSTA describes its proposed fund as “dynamic,”[6] which appears to mean that the size of the fund could increase without limit to accommodate changing costs and revenues.

NYSTA seeks to justify its proposal in terms of the “unique role” that its members play in the provision of universal service.[7] The point that NYSTA misses is that this should not be a “unique role” — it should be a function of the competitive market as a whole. That is the central message of two decades of Commission policy and precedent focused on transitioning from monopoly markets to robustly competitive ones. In effect, NYSTA’s proposal would represent a reversal of that policy, and a return to the early twentieth century paradigm of comprehensive regulation and a guaranteed rate of return.

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[5] *See* Tr. 103; Ex. 19.

[6] *See, e.g.*, Tr. 25, 28, 53. The consequences of the “dynamic” nature of NYSTA’s proposal are discussed further in Section VI(C), below.

[7] Tr. 47. NYSTA’s related claim that the creation of a fund is justified by its members’ supposed role as “carriers of last resort” is refuted at Tr. 703-06.

B. STAFF'S PROPOSAL

Staff supports the creation of a limited-duration (three- to five-year) fund.[8] Under Staff's proposal, a company seeking funding would be required to undergo a full rate case review which would determine whether the company's revenue requirement can be met by setting basic local service rates at a specified rate ceiling, or "benchmark." If the revenue requirement cannot be met, "a further analysis will be used to determine the funding level for an eligible company."[9] This "further analysis" would entail a review of the company's "total company regulated operations" and would include consideration of "adjustments not normally made in traditional rate cases — such as plant write-downs and consideration of additional operating efficiencies."[10]

The existence of "substitutable alternative providers" in a company's service area would also be taken into account in determining eligibility for funding under Staff's proposal. If substitutable providers cover the company's entire service area, then no funding would be provided. If such providers do not cover the entire service area, then the most efficient alternative for serving white spot areas would be identified. That alternative might be "provid[ing] funding to the ILEC to continue operations," or "fund[ing] the build out of the substitutable provider(s) network(s) to reach all customers currently served by the ILEC."[11] Although Verizon supports Staff's recognition that providing full funding to incumbent providers may not be the most efficient way to ensure service in white-spot areas, and that the availability of alternative providers

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[8] Staff has proposed "key principles" to guide the development of a fund, rather than specific details. (Tr. 520.)

[9] Tr. 522.

[10] Tr. 525-27.

[11] Tr. 523; *see also* Ex. 35.

must be taken into account, Staff's view of what constitutes a "substitutable provider" is far too narrow.

Staff's proposal would require contributions from CMRS and VoIP providers as well as regulated telephone corporations, with the option for contributing companies to attempt to recover their contributions through an end-user surcharge. Staff estimates the size of the fund at $5.6 million, but, like NYSTA, its proposal does not include any sort of limitation on fund size or guarantee that the fund will remain at or below the estimated level.[12]

To the extent that it recognizes that a rate-of-return guarantee is neither feasible nor desirable in today's world, Staff's position is somewhat closer to the spirit of Verizon's proposals than the more extreme NYSTA position. Nevertheless, as we discuss below, the creation of *any* new fund would have detrimental consequences for competition, fairness, and, indeed, for universal service itself, and the Commission therefore should not adopt Staff's proposal.

Staff's proposal is rooted in the view (set forth in the testimony of the Staff Policy Panel) that in the universal service context, competition is the problem rather than the solution — "[t]o pretend there is no downside to competition, specifically a negative impact to universal service[,] would be shortsighted."[13] But that view is squarely in conflict with the policy guidance provided by the *Competition III Order,* in which the Commission emphasized the continued importance of the pro-competitive policies that it had been espousing for almost two decades:

> Technology is changing the nature of telecommunications services and accelerating the rate and level of competition in a historically monopolistic

[12] Tr. 546-48. Staff initially estimated the size of the fund at $5 million. This was corrected to $5.6 million in Staff's response to CTANY-DPS-8.

[13] Tr. 593.

> industry. Failure to adapt New York's regulatory regime to these changing dynamics will place the State at a competitive disadvantage by stifling investments and upgrades to the telecommunications infrastructure that is supporting the State's economic activities.[14]

The Commission went on to observe that achieving the objective of economic development "requires a level playing field where all telecommunications service providers have the proper market incentives to invest in infrastructure"[15] and declared that it seeks "to maintain New York as the most competitive market in the nation for new telecommunications services by eliminating unnecessary, bureaucratic and anachronistic requirements that hamstring investment and the expansion of competition."[16] It expressed its faith that "competition spurs innovation, promotes investment, encourages efficiency, and maximizes customer choice."[17]

The Staff Policy Panel's views are inconsistent with the Commission's vision, as is the Staff proposal that is based on those views. Establishing a fund is unnecessary to maintain universal service; and will undermine each of the pro-competitive policies identified above by tilting the level playing field, imposing new "unnecessary, bureaucratic and anachronistic requirements," deterring innovation and investment, and discouraging efficiency.

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[14] Case 05-C-0616, "Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings" (issued and effective April 11, 2006) ("*Competition III Order*"), at 3.

[15] *Id.*

[16] *Id.*

[17] *Id.* at 6.

C. AT&T'S PROPOSAL

AT&T proposes a three-year extension of the TF, initially at 150% of the current funding level, but growing to 200% by 2013.[18] Existing recipients would continue to receive funding, additional companies could petition for support, and any party could petition for an investigation if the cap on the fund is reached. (AT&T refers to this approach as a "soft cap."[19]) The proposal would utilize the TF's rate-case methodology to determine funding levels and the benchmark rate would be 125% of Verizon's current ($23.00/month) basic local service rate.

AT&T seeks to position its proposal as a "middle ground" between the views of other parties. It suggests that the proposal is a non-controversial "quick fix" that can be adopted on an interim basis so that the Commission can move quickly on to issues that are more important to AT&T — in particular, access charge reductions.[20] In reality, however, its proposal is much more than a simple continuation of current policy for a short, additional period. As we discuss in greater detail below, the TF was explicitly created as a temporary resource supported by a fixed source of funding and utilizing an existing contribution mechanism. The Temporary Transition Fund Extension agreed to by the parties and approved by the Commission in this proceeding did not change the fundamental character of the TF — indeed, that Extension was put in place simply in order to allow sufficient time for the litigation of the important policy, legal, and factual issues that are being addressed in this proceeding. The AT&T proposal, on the other hand, would

[18] *See* Tr. 755-57, 766-69, 773-74 (AT&T Direct Testimony); Tr. 777-79, 785 (AT&T Rebuttal Testimony); Tr. 690-93 (Verizon Rebuttal Testimony).

[19] Tr. 766.

[20] *See, e.g.,* Tr. 766 ("Pragmatically, . . . the Commission can simply extend the fund on a limited, transitional basis and then undertake the necessary step of addressing intrastate switched access reform.").

institutionalize this temporary arrangement and would even permit the fund to grow significantly. Even more importantly, AT&T would expand the fund's contribution base to include CMRS and VoIP providers — a highly significant change from the status quo with important legal and policy implications.

Although AT&T argues that its interim proposal would impose no more than a minimal burden on any party, in fact it would fail to provide any safeguards against the indefinite expansion of the fund. The risk of such unanticipated expansion is illustrated by the experience of the Federal High-Cost USF,[21] and by Staff's and NYSTA's projections of likely fund size — $5.6 million and $10 million, respectively — both of which are considerably above AT&T's estimate, and both of which are themselves subject to uncontrolled expansion. The fact is that once a fund is established, proposals to change or restrict it are likely to meet delay and resistance because those who receive funding will quickly become dependent on it. A fund that is not explicitly and irrevocably capped would thus as a practical matter tend to operate as a one-way ratchet — never contracting, and always subject to expansion.

AT&T's proposal would represent a major departure from current policy — one that should not be considered without careful analysis of the underlying legal and policy issues. AT&T's "middle ground" rhetoric is simply a device designed to persuade the Commission that it can implement a new fund without worrying about those issues. But the issues surrounding the creation of a fund are too important to be resolved in the curtailed manner that AT&T proposes.

[21] T-Mobile testified that the federal quarterly USF contribution factor was 6.68 percent ten years ago, and it is proposed to increase to 15.5 percent for the current quarter. *See* T-Mobile Direct Testimony (Ex. 87) at 11.

III. THE COMMISSION HAS NO AUTHORITY TO ADOPT THE FUNDING PROPOSALS PUT FORWARD IN THIS PROCEEDING

Even if funding made sense from the policy perspective — and it does not — there would nevertheless be several fundamental legal obstacles to the creation of a fund. There are three separate legal authority issues presented by the funding proposals in this case: (a) the Commission's general lack of authority to create a fund; (b) its lack of authority to compel intermodal providers to contribute to such a fund[22]; and (c) its lack of authority to compel contributions from regulated companies that are not themselves earning a reasonable rate of return.[23]

A. THE COMMISSION'S GENERAL AUTHORITY TO ESTABLISH A FUND

It is black-letter law that the Commission, "like all State agencies or commissions, has only those powers which have been specifically conferred upon it by statute, together with such implied powers as are necessary to carry out the specified grant . . . ."[24] When the Commission goes beyond those powers, its actions are subject to nullification by the courts. Since the Public Service Law clearly does not expressly confer upon the Commission the authority to create a

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[22] NYSTA, Staff, and AT&T would all require CMRS providers to contribute to their proposed funds.

[23] Authority issues — being legal matters — were addressed sketchily if at all in the parties' testimony. As a result, it is possible that some parties may choose not to address such issues in their initial briefs. Verizon submits that such holding back would be contrary to the spirit of the procedural rulings in this case, and it explicitly reserves its right to submit responses to any authority arguments raised for the first time in reply briefs.

[24] *City of New York v. Public Serv. Comm'n*, 53 A.D.2d 164, 165, 385 N.Y.S.2d 634, 635 (3d Dep't 1976), *aff'd on the opinions below*, 42 N.Y.2d 916, 397 N.Y.S.2d 1005, 366 N.E.2d 1359 (1977).

universal service fund,[25] the issue is whether such action would be within the scope of the Commission's implied powers.

Even assuming, *arguendo*, that the advancement of universal service is a permissible Commission *goal*, the establishment of a fund is not an authorized *means* to achieve that end. The powers over regulated telephone corporations that the Public Service Law grants to the Commission relate to the offering of regulated services by such corporations (and the terms and conditions on which those services are offered), the means and instrumentalities that are used to provide those services, and certain aspects of financing, ownership, control, and affiliation.[26] Under these provisions the Commission manifestly has power to set rates for regulated services (including wholesale services subject to state regulation — thus to some extent shifting revenues between providers), but nothing in the Public Service Law authorizes the Commission simply to collect money from some providers in order to distribute it for the benefit of others. Such authority is neither expressly granted by the Law nor implied in any of its express grants. Indeed, where monetary payments by telephone corporations are contemplated, they are explicitly authorized (and limited), as is the case for assessments, penalties, and refunds.[27] Except in the context of these narrowly drawn delegations, the Commission has no power to collect money from regulated utilities in order to advance its regulatory objectives.

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[25] The Public Service Law does, however, include specific delegations of authority to create other types of funds, demonstrating that the Legislature knew how to confer such authority when it wanted to do so. *See, e.g.,* Publ. Serv. L. §§ 66-k(2) (air pollution migration fund), 135-d(5) (awareness program for energy conservation).

[26] *See, e.g.,* Publ. Serv. L. §§ 91, 92, 94, 99, 100, 110.

[27] *See, e.g.,* Publ. Serv. L. §§ 18-a (assessments), 25 (penalties), 113 (refunds and reparations).

This distinction between means and ends is crucial to the scope of the Commission's authority. It is well-established that the Commission may not pursue an objective through means that the Legislature has not authorized. *City of New York v. Public Service Comm'n*[28] is directly on point. There the court overturned a Commission order which, on privacy grounds, required telephone corporations to notify their customers when the customers' records were subpoenaed. Although it may be assumed that protecting customer privacy is a legitimate Commission objective — indeed, the Commission's decisions on Caller ID and ANI services, among others, were based largely on that rationale[29] — the court found that the Commission had no jurisdiction over a regulated company's subpoena-processing procedures, regardless of the customer privacy interests at stake. "The Public Service Law, not the Constitution, circumscribes the area over which the PSC can exercise jurisdiction and control. In general, this area is to insure proper and adequate telephone service at reasonable cost to the public."[30]

> Conceding the PSC all the authority granted to it statutorily and all the powers incidental and necessary to effect the duties and obligations imposed, the subject order is clearly concerned with nonutility activity. It is basic that an affirmative obligation exists on behalf of the commission to insure that the public utilities under its supervision act in the best interests of the public. . . . [T]he protection extends to those services usually and necessarily performed by such utility . . . . The concern and extent of the PSC with telephone subscriber's individual constitutional rights can neither be

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[28] 84 Misc. 2d 1058, 379 N.Y.S.2d 987 (Sup. Ct. Albany Co. 1976). The decision was affirmed by the Appellate Division and the Court of Appeals. *See* citations in footnote 24, above.

[29] *See, e.g.,* Cases 89-C-191 and 90-C-0165, "Opinion and Order Approving Automatic Number Identification Terms and Conditions for All Communications Companies and Denying Petition for Reconsideration" (Op. No. 94-9) (issued and effective March 30, 1994); Case 91-C-0428, "Opinion and Order Authorizing Caller ID Service" (Op. No. 92-5) (issued and effective April 9, 1992).

[30] 84 Misc. 2d at 1061, 379 N.Y.S.3d at 991.

> concluded nor implied. Those individual constitutional rights are matters for the courts, not for an administrative or regulatory agency.[31]

Accordingly, the court determined that the Commission's order could not be justified "under the commission's concern with individual rights to privacy *even if that were a legitimate concern of the commission.*"[32] In its affirmance, the Appellate Division noted that the Commission's order "involve[d] activities which are not exclusively 'utility' actions and are, therefore, beyond the reach of PSC jurisdiction as set forth in the Public Service Law."[33] Here, too, requiring regulated utilities to contribute to a fund would be tantamount to regulating activities "which are not exclusively 'utility actions.'"

Indeed, the creation of a universal service fund would be a classic instance of taxation — a function that is by state constitutional mandate reserved to the Legislature and may not be delegated to administrative agencies unless the Legislature "specif[ies] the types of taxes which may be imposed" and "provide[s] for their review."[34] (Alternatively, mandated fund contributions

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[31] 84 Misc. 2d at 1062, 379 N.Y.S.2d at 992.

[32] 84 Misc. 2d at 1063, 379 N.Y.S.2d at 992.

[33] 53 A.D.2d at 165-66, 385 N.Y.S.2d at 636.

[34] *See, e.g.,* New York State Constitution, Art. XVI, § 1 ("Any laws which delegate the taxing power shall specify the types of taxes which may be imposed thereunder and provide for their review."); *Greater Poughkeepsie Library Dist. V. Town of Poughkeepsie*, 81 N.Y.2d 574, 601 N.Y.S.2d 94, 618 N.E.2d 1227 (1993) (state statute required a Town to levy a tax to fund a Library District; where the amount that must be raised can fluctuate based in part on variables determined by the Library District, the Library District had the power to "effectively fix the Town's tax rate," resulting in an impermissible delegation of taxing power).

"A tax is a charge that a government exacts from a citizen to defray the general costs of government unrelated to any particular benefit received by that citizen . . . . Only legislative bodies have the power to impose taxes . . . ." *Walton v. Dep't of Correctional Serv.*, 13 N.Y.2d 475, 485, 893 N.Y.S.2d 453, 921 N.E.2d 145, 151 (2009). Here, none of the funding proposals seek to tie assessments from the contributing companies to any "particular benefit received by" such companies. Although agencies may assess regulatory "fees," as distinct from taxes, "[i]n the regulatory arena, fees must bear at least 'a rough correlation to the expense to which the State is put in administering its licensing procedures or to the benefits that those who make the payments receive' . . . ." *Id.* That is not the case here. Nor do the proposed universal-service assessments meet the usual definition of fees, in

(continued …)

could be characterized as "assessments" that are not authorized by Publ. Serv. L. § 18-a or by any other provision of the Public Service Law.) Unlike the situation that may exist in other states (where universal service funds were created by state statute), the Public Service Law contains no such "specifi[cation]."[35]

Nor, contrary to AT&T's claim,[36] does federal law clothe the Commission with the necessary authority. Even if § 254(f) of the Telecommunications Act were considered to provide

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(…continued)

that they are not "paid to obtain access to a governmental service or benefit, such as the fees paid to obtain licenses to practice professions in particular jurisdictions." *Id.* (In *Walton*, the Court rejected a tax-based challenge to a commission arrangement between the State Department of Correctional Services and the company that provided payphone services in state prisons. The Court found that the commission was not a tax on the end users paying for the calls made from the phones, primarily because it was not an instance of governmental coercion but rather grew out of a voluntary contractual arrangement between the agency and the service provider. The same cannot be said of the fund assessments proposed here.)

[35] Challenges to state universal service fund assessments on the grounds that they represent unauthorized taxation have been rejected in some cases relating to universal service funds in other states. However, many of those cases involved a very different situation than that presented here. In some cases there was an explicit state statute authorizing the fund (so that no question arose as to the commission's authority under state law), or the commission derived broad powers directly from the state constitution (so that no question arose as to the scope of a legislative delegation), or the fund in question was narrowly designed to replace a specific source of revenue (*e.g.*, access charges) taken from providers by regulatory action. None of these factors exists here. There is no New York statute specifically authorizing the creation of a universal service fund and no constitutional grant of power to the Commission, and the purpose of the fund is the far broader one of providing support for financially troubled companies, whatever the source of those troubles. *See, e.g., Schumacher v. Johanns*, 272 Neb. 246, 722 N.W.2d 37 (Neb. 2006) (considering a fund that had been authorized by state statute and that the state commission initially applied to offset reductions in access revenues; commission's authority derived from state constitution); *Voicestream GSM I Operating Co. v. Louisiana Publ. Serv. Comm'n*,, 943 S.3d 349 (La. 2006) (commission's authority derived from state constitution; "[t]he Louisiana Constitution grants the LPSC plenary authority over the regulation of all public utilities thereby providing a broad and independent power and authority to regulate"); *Bell Atl. Mobile v. Dep't Publ. Util. Control*, 1999 Conn. Super. LEXIS 553, *aff'd*, 253 Conn. 453, 754 A.2d 128 (Conn. 2000) (state universal service fund authorized by statute).

In any event, the question of whether universal service assessments by the Commission are tantamount to unconstitutional taxation is independent of the question of whether such assessments are authorized in the first place. In view of the fact that the Public Service Law does *not* authorize the Commission to establish a universal service fund, the establishment of such a fund would be *ultra vires* whether or not fund assessments amount to a tax.

[36] Tr. 770.

a *federal* authorization for the creation of universal service funds by a state (a proposition that is far from clear[37]), the Commission — whose jurisdiction is defined and limited by state law — would lack power to act on that delegation. Rather, such authority would have to be exercised by the State's Legislature, subject to the Legislature's proper exercise, at some point in the future, of any power it might have to sub-delegate that authority to a state agency such as the Commission.

Accordingly, the Commission has no authority to collect revenues from some providers in order to transfer them to other providers through a fund mechanism.[38]

B. THE COMMISSION LACKS POWER TO REQUIRE CONTRIBUTIONS TO A FUND BY INTERMODAL PROVIDERS

Even if the Commission had general authority to create a fund, it has no power to compel contributions to that fund by providers of intermodal services such as CMRS. Compelling contributions to a fund would obviously be an exercise of regulatory authority; thus, if a provider's service is not subject to Commission regulation, the Commission has no authority to assess fund contributions from the provider. VoIP is an interstate information service,[39] and thus

[37] As discussed below, none of the fund proposals put forward in this proceeding addresses the unreasonableness of requiring contributions from companies with lower return levels than the providers that are seeking funding. Aside from other objections that might be raised to the theory that § 254 serves as an independent source of State authority, this fact raises the issue of whether such proposals would even meet the substantive requirements of § 254. *See* the FCC decisions and federal cases cited in footnote 97, *infra*.

[38] The fact that the Commission created the TAF and the TF should not be taken as a precedent for further exercises in fund creation. The TAF was widely supported — *see* Case 94-C-0095, "Opinion and Order Adopting Regulatory Framework" (Op. No. 96-13) (issued and effective May 22, 1996) ("*Framework* Order"), at 12 (noting that "there is broad agreement" for funding Lifeline, 911, and Telecommunications Relay Service). To the best of Verizon's knowledge, the only challenge to the Commission's authority to establish the TAF focused on the legality of assessing cellular providers — an issue that was resolved when the Commission exempted such providers from any contribution obligation (*see* Section III(B), below). Similarly, both the TF and the Temporary TF Extension were created as a result of Commission approvals of settlements. These consensual funds thus provide no basis for creating an additional fund, and in any event cannot vest the Commission with authority not given to it by the Legislature.

[39] *See, e.g., PaeTec Communications, Inc. v. Commpartners, LLC*, 2010 U.S. Dist. LEXIS 51926 (S.D.N.Y.), at *7. Although the Commission reached a contrary conclusion in 2004 — Case 03-C-1285, "Order Establishing

(continued …)

is outside the scope of the Commission's authority, and the Commission's regulatory jurisdiction over CMRS providers is expressly limited by Publ. Serv. L. § 5(6)(a):[40]

> Application of the provisions of this chapter [*i.e.*, the Public Service Law] to cellular telephone services is suspended unless the commission, no sooner than one year after the effective date of this subdivision, makes a determination, after notice and hearing, that suspension of the application of the provisions of this chapter shall cease to the extent found necessary to protect the public interest.

To date, the Commission has issued no such notice, held no such hearing, and made no such determination — nor would it be justified in making such a determination. Thus, at present the provisions of the Public Service Law clearly cannot be applied to any "cellular telephone services" and cannot be used to justify USF assessments from such services. Indeed, this was precisely the ground on which the Commission exempted wireless carriers from the obligation to contribute to the TAF.[41]

(…continued)

Balanced Regulatory Framework for Vonage Holdings Corp." (issued and effective May 21, 2004), at 11-13 — enforcement of that order was enjoined by a federal court. *See Vonage Holdings Corp. v. Publ. Serv. Comm'n*, 04 Civ. 4306 (DFE), Preliminary Injunction Order (S.D.N.Y. July 16, 2004); *id.*, 2005 U.S. Dist. LEXIS 33121 (S.D.N.Y. December 14, 2005). In any event, in 2004 the Commission did not have the benefit of the extensive discussion of that issue that has taken place in the last seven years, including decisions such as the one cited above.

[40] Further, certain forms of regulatory authority over wireless services may be limited or pre-empted by federal law. *See* 47 U.S.C. § 332(c).

[41] *See* Cases 94-C-0095 and 28425, "Opinion and Order Establishing Access Charges for New York Telephone Company and Instituting a Targeted Accessibility Fund" (Op. No. 98-10) (issued and effective June 2, 1998). Section 5(6)(a) was enacted *after* a collaborative working group of the parties had made its recommendations concerning the TAF, but before the Commission issued Opinion No. 98-10. The Commission solicited comments on the effect of the amendments, and Bell Atlantic Mobile argued that any Commission attempt to require participation in TAF by cellular and PCS carriers would violate both federal and state law, including § 5(6) *Id.* at 34-35. The Commission ruled that it would "grant the state law exception as to exemption of cellular services from any Fund charges"; accordingly, it saw no need to address the federal law issues that had been raised by Bell Atlantic Mobile. *Id.* at 37. The Commission explicitly recognized that the exemption was required by the Public Service Law by stating that it might "review the necessity of assessing cellular services for universal

(continued …)

NYSTA (which supports the assessment of contributions from CMRS providers) argues that sufficient notice under § 5(6)(a) was provided by the Commission's indication that it would "undertake the policy issues arising from the exhaustion of the Transition Fund."[42] The response of T-Mobile's witness to this dubious contention is cogent and irrefutable:

> I am unaware of any Commission order or notice in this proceeding that proposes termination of the suspension provided by [§ 5(6)(a)]. The NYSTA Panel cites the participation of T-Mobile, AT&T, and Verizon Wireless in this proceeding as evidence that notice has been given. However, eleven facilities-based wireless carriers provide service in New York. Even if participation in this proceeding were evidence of "notice" (it is not), the fact that four of the eleven facilities-based wireless carriers providing service in New York have participated would be outweighed by the fact that the remaining seven, and all wireless resellers, have not.[43]

Beyond the point made by T-Mobile, nothing in the notices issued in this case provided any indication that the Commission would reconsider the regulatory framework for CMRS carriers pursuant to § 5(6)(a). Such action would be far too significant to permit the Commission to treat it as included by implication in a notice of a general proceeding related to universal service.

C. THE COMMISSION LACKS POWER TO REQUIRE CONTRIBUTIONS BY UNDER-EARNING REGULATED TELEPHONE CORPORATIONS

As discussed in greater detail below, in many respects the financial metrics of Verizon are far worse than those of the NYSTA companies and other providers that might be seeking funding

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(…continued)

service purposes, including the TAF, *in such manner and at such time as complies with the Public Service Law.*" *Id.* (emphasis supplied).

[42] Tr. 96.

[43] T-Mobile Rebuttal Testimony (Ex. 87), at 12 (footnote omitted).

on the grounds of an inadequate rate of return. Taxing Verizon to contribute to a fund for the benefit of such companies would be perverse from a policy perspective (as we discuss in greater detail below), but it would also violate the express mandate of § 97(1) of the Public Service Law.

That section provides that:

> Whenever the commission shall be of the opinion, after a hearing . . . that the rates . . . charged by any . . . telephone corporation subject to its jurisdiction . . . are unjust [or] unreasonable . . . the commission shall, with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservation out of income for surplus and contingencies, determine the just and reasonable rates . . . to be thereafter observed and in force . . . . [Emphasis supplied]

This limitation on the Commission's rate jurisdiction would obviously have to be applied equally as a limitation on its power — if it had any — to tax some service providers for the benefit of others. Yet taking from a company with lower returns to give to one with higher returns could hardly be considered consistent with the mandate to give "due regard" to "a reasonable average return."[44] Indeed, § 97 aside, such an action would lack a rational basis and thus would be subject to vacatur under CPLR § 7803 as arbitrary, capricious, and unsupported by substantial evidence.

[44] Such action would also violate the Due Process and Takings provisions of the United States and New York Constitutions, since a regulated utility is entitled to an opportunity to recover its expenses and a fair rate of return on its capital investments. *See, e.g.*, *F.P.C. v. Hope Natural Gas Co.,* 320 U.S. 591 (1944). It is worth noting, however, that the elements of a constitutional violation need not be established in order to show a violation of § 97(1). *New York Tel. Co. v. Publ. Serv. Comm'n*, 62 N.Y.2d 57, 63, 476 N.Y.2d 60, 63, 464 N.E.2d 428, 431 (1984).

IV. PARTIES PROPOSING A FUND HAVE THE BURDEN OF DEMONSTRATING THAT THEIR PROPOSALS ARE LAWFUL AND CONSISTENT WITH THE PUBLIC INTEREST

A universal service fund providing explicit financial support to under-earning companies would be a new feature of the New York regulatory landscape. Proposals to create some form of high-cost funding arrangement have been put before the Commission on a number of occasions over the last two decades, and the Commission has consistently declined to adopt them.[45] Although in 1998 the Commission created the TAF, the TAF has the narrow purpose of advancing a limited number of clearly-defined public policy objectives by providing support for E911, Telecommunications Relay Service, and Lifeline. It does not provide general financial support for telephone corporations with purportedly high costs, low revenues, or inadequate rates of return.

Nor does the TF provide any precedent for the creation of a new fund. The TF was explicitly created as a temporary device utilizing a fixed source of funding. Moreover, it was known that the TF's funding source would likely be exhausted within a limited period of time. The very name "Transition Fund" indicates the expectation that the TF would mediate a transition

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[45] *See, e.g.,* Case 28425, "Opinion and Order on Pooling, Collocation and Access Rate Design" (Op. No. 92-13) (issued and effective May 29, 1992), at 5 (leaving "some matters for future resolution, including . . . whether to establish a 'high cost fund' to ensure that secondary carriers with high costs will not have to charge access rates significantly above the statewide average"); Cases 94-C-0095 and 28425, "Order Resolving Issues Related to Independent Telephone Companies' Access Charges, the 1998 Ice Storm and Other Matters" (issued and effective December 4, 1998), at 9 (finding no need to "begin development of a rate affordability fund at the present time"); *Competition III Order* at 75-76 (agreeing with Staff's conclusion that a state high cost fund "is unnecessary at this point . . . .").

NYSTA argues that these prior decisions somehow do not count because they are explained by the existence of the TF (which made any other fund unnecessary). (Tr. 141-44.) But that contention is irrelevant to Verizon's point that there is no New York precedent for a permanent fund to protect the finances of under-earning incumbent providers, and that such a fund would thus be a novel development that would require an affirmative showing of good cause. Moreover, NYSTA's contention is not even true for the decisions cited above that preceded the creation of the TF in 2003.

to financial self-reliance on the part of the funded companies. Although the settlement that created the TF also established a process (the "Fund Track") for considering possible successor arrangements, there was no guarantee that any such arrangement would be put in place. Indeed, one of the issues listed for consideration in such a future proceeding was the fundamental one of whether a successor fund should be created at all.[46] The Commission specifically noted that it had approved the settlement creating the TF

> without any prejudgment of the need for or nature of a longer-term universal service fund that might follow exhaustion of the Transition Fund . . . . The Plan defers all such matters to the Fund Track . . . and recognizes . . . that all parties reserve their rights as to the positions they will take in the Fund Track. Accordingly, we need not comment further on those matters.[47]

Thus, the mere existence of the TF provides no guarantee of or justification for the creation of a successor fund.

In view of this history, as well as the competitive markets that now exist throughout the State, the burden should be on the proponents of a fund to demonstrate the need for and appropriateness of such a significant change in direction by the Commission.

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[46] *See* Case 02-C-0595, "Comprehensive Plan, Phase II" (attached to Case 02-C-0595, "Order Adopting Comprehensive Plan" (issued and effective December 23, 2003) [the "*Transition Fund Order*"]), ¶ 10(a) ("A separate Fund Track will be established to address all issues associated with the need for, establishment of, administration of, and recovery of disbursements from any funding arrangement designed to replace the Transition Fund described herein."); *id.* ¶ 10(b) ("The Issues to be addressed in this Fund Track include, but are not limited to, the following: 1. Should a fund be established?").

[47] *Transition Fund Order* at 11.

V. THE CREATION OF A NEW FUND IS NOT NECESSARY TO MAINTAIN UNIVERSAL SERVICE IN NEW YORK, AND THERE IS NO OTHER LAWFUL AND APPROPRIATE PURPOSE FOR A FUND

A. COMPETITIVE ALTERNATIVES TO THE ILECS' SERVICES ARE WIDELY AVAILABLE

As the Staff Substitutability Panel recognized, "A funding mechanism would not be necessary if the phone services offered by competitive providers could be used to maintain universal service."[48] In fact, that is the case. Intermodal providers offer facilities-based alternatives to the services provided by incumbent LECs in virtually every part of the State, and as a result providing financial support to the incumbents through a fund is not necessary to preserve universal service. Several lines of evidence clearly establish that this is the case:

- In a study based on 2004 data that was conducted in connection with the Commission's Competition III proceeding, Staff concluded that 89.53% of New Yorkers had at least two facilities-based, *i.e.*, intermodal, alternatives available to them.[49]
- In 2007, Staff, "as a follow-up to the Comp III Proceeding," carried out a statistically-validated telephone survey of approximately 1,500 residential consumers in New York.[50] Using a modified, "more granular" approach based on that survey, Staff concluded that the percentage of consumers with two or more intermodal options had increased to 95%.[51]

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48 Tr. 466.

49 *See* Case 05-C-0616, Department of Public Service, "Telecommunications in New York: Competition and Consumer Protection" (September 21, 2005), Appendix E, Table 1.

50 *See* New York State Department of Public Service, "New York State Residential Telecommunications Consumer Survey" (April 20, 2007), at 3.

51 *Id.* at 3-4, 7-9, 40-43. The survey results were conservative as a result of the fact that Staff's telephone survey of State residents excluded cellular numbers — thus by fiat eliminating a significant group of customers utilizing a competitive alternative to traditional wireline service.

- In late 2009, Staff conducted a study in this proceeding and concluded that "most of New York's 19 million residents have alternative phone options."[52] One of Staff's analyses, for example, found that only about one-half of one percent of upstate property locations have no cable modem or wireless service available.[53] The results of the study were subsequently validated by spot field visits by Staff.[54]

- Verizon has updated and supplemented this prior work with a new analysis of CMRS and VoIP competition in the independent telephone company service areas in the State.[55] This study utilized: (a) Census Bureau data and related geospatial data sets to identify the locations of households in the relevant service areas; (b) data from the State Office of Cyber Security to identify the areas in which cable modem service or other broadband alternatives are available; and (c) American Roamer and Verizon wireless data to identify CMRS service areas. The study demonstrates that over 99 percent of the households in the independent telephone company service areas have at least one intermodal alternative available to them, and over 82 percent have at least two alternatives.

Despite some differences in approach and time period, both the Staff and Verizon studies support the same general conclusion — that competitive alternatives are available today to all but a very few households in the independent telephone company service areas.[56] In fact, the percentage of households currently without intermodal alternatives is less than the percentage of

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[52] Case 09-M-0527, "Preliminary Staff Report on Cable and Wireless Phone Coverage" (December 22, 2009) ("*Staff Report*") (marked in this proceeding as Ex. 39), at 2. *See generally* Tr. 416-30.

[53] *Id*. at 7.

[54] Tr. 434-42 (Direct Testimony of Staff White Spots Panel).

[55] *See* Tr. 630-33. A detailed description of the methodology and results of Verizon's study was marked as Ex. 83.

[56] Tr. 455-56 (Rebuttal Testimony of Staff White Spots Panel) ("With respect to Verizon's more recent GIS analysis of competitive phone services, it is Staff's understanding that Verizon's analysis identified more residential premises without cable modem service because Verizon used CSCIC/OCS's more recent and refined cable coverage information. Staff's Coverage Report GIS mapping method was essentially the same as the Verizon method, but available cable modem data has changed between then and now. Since the Verizon method relied upon updated data, it likely produced a different estimate of cable modem availability/non-availability than the Staff analysis of two years ago.") Staff's total count of households in the service areas of the smaller ILECs and Frontier with competitive alternatives available to them is only about 5% lower than Verizon's count (based on a comparison of the data presented in Ex. 83, Pgs. 174-176 and Redacted Ex. 39, page 8), a discrepancy that can be explained by the fact that Verizon and Staff used different methodologies for locating households and, as Staff's White Spots Panel stated, by the fact that Verizon's study is based upon more recent data.

customers without telephone service in 2008 (2.1 percent[57] — a level that is generally considered sufficient to constitute "universal service"). Thus, the findings and study demonstrate that the goal of universal service in the independent territories is not dependent on the services of the incumbent providers themselves, and that subsidizing those providers to ensure the continuation of universal service is unnecessary.

Moreover, the testimony of the Staff White Spots Panel demonstrates that the availability of competitive alternatives is expanding (and that white spots are therefore contracting or disappearing). For instance, the Panel indicates that "[o]verall, wireless service coverage in the state has increased by 4.7%, from 85.2% to 89.9% since the [2009] Coverage report was issued."[58] The panel further notes that "there are 92 incorporated municipalities statewide without cable networks, down slightly from the 94 identified in the [late 2009] Coverage Report."[59] This expansion of alternative facilities, along with the observation of Staff that the "federal stimulus grants . . . have been awarded for proposed broadband network construction in parts of the state . . .",[60] clearly show that the availability of competitive alternatives is growing in the territories served by the NYSTA Smaller ILECs.[61]

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[57] *See* Response to CTANY-DPS-1 (copy attached to this brief as Attachment 1).

[58] Tr. 431.

[59] Tr. 432.

[60] Tr. 434.

[61] *See also* Tr. 431-34, 441-42; Ex. 40.

B. THE AVAILABLE ALTERNATIVES ARE REASONABLE SUBSTITUTES FOR THE ILECS' SERVICES

Unable to challenge in any meaningful way the Verizon and Staff findings on the ubiquitous availability of competitive alternatives, NYSTA and other parties seek to minimize their significance by claiming that the services of intermodal providers are not "substitutable" for those of traditional landline providers.

In the eyes of many parties, making the substitutability determination requires a detailed comparative evaluation of the characteristics of traditional and competitive services, together with an identification of those characteristics that are "important." But the question here is not whether traditional and alternative services are equivalent under some abstract model of service "value," or in the view of a particular provider or regulator. Rather, the adequacy of alternatives to traditional services should be judged by the test of the market — *i.e.*, whether there is substantial consumer acceptance of the alternative. No other test is as meaningful or as consistent with the Commission's stated policy favoring market discipline through competition — where competition exists — over market discipline through traditional regulation. Competition is about the primacy of customer choice — it is a mechanism that enables customers to decide for themselves what they want and to "vote with their feet," rather than having providers or regulators decide for them what features, functionalities, and services they want or "need."[62] The test of the market is the only "substitutability" test that should be applied in this proceeding.

Commercially available CMRS and VoIP services (both fixed and application-based) meet this test. Both have achieved widespread consumer acceptance and indeed in some areas are

[62] Tr. 632-35.

achieving penetration levels approaching or exceeding those of incumbent providers. Almost five years ago, in the *Competition III Order*, the Commission stated that "[i]n our judgment, consumers view these offerings as close substitutes to wireline local service."[63]

Developments since 2006, when the *Competition III Order* was issued, corroborate the Commission's conclusions. With respect to CMRS service, one such development is the growing percentage of "cord-cutters" who forego landline service altogether in favor of wireless alternatives. According to the most recent report on cord-cutting by the Centers for Disease Control, "More than one of every four American homes (26.6%) had only wireless telephones . . . during the first half of 2010 — an increase of 2.1 percentage points since the second half of 2009. In addition, nearly one of every six American homes (15.9%) received all or almost all calls on wireless telephones despite having a landline."[64] The percentage of households with only landline service has decreased from 23.8% (in the first half of 2007) to only 12.9% (in the first half of 2010).[65] The trend toward wireless-only households will only accelerate as the segment of the population that never subscribed to wireline service continues to grow. Indeed, more than half of adults aged 25-29 (51.3%) now live in households with only wireless telephones.[66]

The figures related to VoIP penetration are equally striking. As of the end of 2009, *46 percent* of all residential wirelines in the State were provided by non-ILECs, and of these non-

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[63] *Competition III Order* at 34; *see also id.* at 33 n.72, 34-35.

[64] Blumberg S.J., Luke J.V., "Wireless substitution: Early release of estimates from the National Health Interview Survey, January-June 2010" (National Center for Health Statistics, December 2010) (the "*CDC Study*"), available at http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201012.htm.

[65] *CDC Study*, Table 1.

[66] *Id.* at 2.

ILEC lines, *almost 90 percent* were interconnected VoIP lines.[67] Cable companies served more than 22 million residential voice customers as of the end of 2009, and analysts predict that the number of mass market customers who have chosen cable voice services will continue to increase and that cable companies will serve an estimated 23-24 million residential voice subscribers by the end of 2010, and 25 million subscribers by the end of 2012.[68]

Some parties seek to minimize the significance of these statistics by highlighting what they consider to be specific weaknesses of VoIP and CMRS services. All that this demonstrates is that different services have different characteristics, and offer consumers different packages of advantages and limitations. For example, a cellphone user may experience reception difficulties in certain locations and in certain circumstances, but, unlike a landline customer, can use his or her phone in the house or away from it.[69] In a competitive market, choosing among these alternatives is the right and responsibility of the consumer. In view of the fact that millions of consumers have chosen in favor of intermodal offerings, such offerings clearly must be taken into account in determining whether "universal service" exists.

CPB states that "[w]hile alternative service providers allow a customer access to E911 services, they cannot guarantee access with the same degree of confidence as a wire line

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[67] FCC, "Local Telephone Competition: Status as of December 31, 2009" (rel. Jan. 2011) (available at http://www.fcc.gov/Daily_Releases/Daily_Business/2011/db0111/DOC-304054A1.pdf), Table 9.

[68] Tr. 639-40.

[69] *See, e.g.,* Tr. 316-17 ("**Q** [A] hundred feet outside of a NYSTA ILEC customer's house where they can receive a wireless call, they can't necessarily receive an ILEC call, is that right? **A** (Steve Watkins [NYSTA]) If that's the way you want to define substitutability. **Q** Okay, is that right? **A** (Steve Watkins) Yes. **Q** If I'm driving down the highway and I have a flat tire, I can't pick up my NYSTA ILEC telephone to make a call to Triple A, right? **A** (Steve Watkins) That's correct.").

service."[70] CPB's statement appears to be based on the fact that intermodal services frequently require a power source, such as batteries for a CMRS handset or commercial power for a VoIP service. However, even conventional wireline services can be provided over fiber, in which case they would depend on the availability of electricity from commercial power and/or batteries, and the Commission has approved tariff provisions that recognize the customer's responsibility to provide power where required.[71] Universal service does not require a particular technology, such as copper wire over which electrical power can be sent to the customer's home. Every technology has drawbacks and limitations. If a tree falls in a storm and takes out the copper twisted pair running to a house or neighborhood, a wireless phone might be the better option to reach emergency services. Indeed, more than half of all calls made to emergency service providers are now made from wireless phones.[72]

No provider can guarantee that its service will be available at all times. Presumably even customers of the NYSTA Smaller ILECs experience occasional service outages or other service-affecting situations. CPB's desire for a guarantee is unrealistic, and its testimony fails to demonstrate that alternative networks are inferior to traditional networks in providing access to emergency services. Indeed, even some governmental agencies, hospitals, and emergency service providers — the types of customers who would be most likely to be sensitive to reliability and service quality concerns — have chosen to switch to competitive alternatives in recent years.[73]

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[70] CPB Direct Testimony (Ex. 89) at 21-22.

[71] *See, e.g.,* Verizon Tariff No. 1, § 1(A)(5).

[72] *See* FCC Consumer Facts, Wireless 911 Services, http://www.fcc.gov/cgb/consumerfacts/wireless911srvc.html.

[73] *See* Tr. 641 (Verizon Initial Testimony) & Ex. 84.

NYSTA takes CPB's contention one giant step further into the realm of scare-mongering by arguing that customers who choose to discontinue their landline service are "potentially endangering their safety as a result."[74] However, the only "evidence" that NYSTA cites for this contention is a July 2009 online article that recommended that customers keep both a landline and wireless phone in order to increase the number of options they have for reaching 911. But this does not lead to the conclusion that customers who choose to cut the cord are endangering their safety. Indeed, under NYSTA's argument it would make just as much sense to subsidize CMRS providers in order to ensure that all customers have a cell phone as a second alternative for emergency calling in addition to their ILEC-provided wireline phone.

CPB, NYSTA, and Staff all argue that intermodal services cannot be considered substitutes for traditional service because they are not regulated by the Commission.[75] The Staff Substitutability Panel takes a somewhat more moderate approach to this issue than NYSTA, arguing that some but not all aspects of traditional regulation must apply in order for an alternative service to be deemed "substitutable,"[76] but the Panel does not offer any empirical evidence to support its claim that the "core characteristics" of regulation that it identifies are important to or expected by consumers. Indeed, Staff's position on this important point is purely

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[74] Tr. 121.

[75] *See, e.g.,* CPB Direct Testimony (Ex. 89) at 18-20, 23; Tr. 24-25, 51, 65-67, 72-77 (NYSTA Direct Testimony); Tr. 466-71 (Direct Testimony of Staff Substitutability Panel). Of course, intermodal providers are subject to various federal regulatory requirements as well as to limitations imposed by general commercial law. *See, e.g.*, T-Mobile Direct Testimony (Ex. 87), at 9-10.

[76] Tr. 466-93.

conclusory. The record of this proceeding clearly demonstrates that consumers *do* regard intermodal services as substitutes for traditional ILEC services, despite their unregulated status.[77]

The Commission should reject the NYSTA, CPB, and Staff positions, and should not require that alternative providers or technologies be subject to the regulatory framework established for traditional wireline POTS service (tariffing, service quality metrics, intra- and interLATA equal access, etc.) in order to "count" for universal service purposes. That test, which could be applied only by ignoring actual market evidence, would impose an artificial and unreasonable barrier to new and innovative technologies, and would be unnecessary to ensure just and reasonable rates and service. Indeed, in a wide range of competitive industries across the economic spectrum, it is the market, not regulation, that determines the acceptability of alternative services and service providers.

Contrary to the views of the Staff Substitutability Panel,[78] the fact that some intermodal providers may not offer Lifeline service does not mean that their services are inadequate for universal service purposes. First of all, some wireless carriers do provide discounted Lifeline

[77] The various aspects of service discussed in the testimony of the Staff Substitutability Panel — the availability of "blocking," for example — are simply parts of an overall "package" of benefits offered by a provider — a package that includes price, functionality, billing options, and branding, as well as numerous other aspects of the customer experience. In any competitive market, the packages offered by different providers will vary widely. Customers, by choosing one provider over another, make their own decisions as to which aspects of the overall package are most important to them. One customer, for example, might choose a credit card issuer that always has live, U.S.-based service representatives answer its customer's calls. Another customer might prefer to forgo that aspect of service in exchange for a lower annual percentage rate, or a "frequent purchaser" rebate program of some sort. In each case, the customer can find a provider that meets his or her preferences. None of these trade-offs — and the increased range of consumer choice that they make possible — would exist if all aspects of service were strictly constrained by regulations. Requiring a company to offer a particular benefit increases a provider's costs, and makes it less able or willing to offer a different benefit.

[78] Tr. 475.

service in New York utilizing federal subsidies.[79] Moreover, the wide variety of price plans and price points offered by CMRS providers enables customers to obtain service at affordable rates with or without specially discounted Lifeline service.[80] In any event, the existence of customers with special needs, such as Lifeline customers, is not a sufficient rationale for propping up an ailing incumbent provider through a new funding mechanism. More efficient, narrowly-targeted alternatives for meeting any such needs exist, such as modifying the TAF so that TAF funds that would otherwise be paid to telephone companies to support their Lifeline services could be used to provide vouchers or other direct subsidies to eligible customers in order to help them pay for intermodal services.

Thus, CMRS and VoIP-based services are fully substitutable for traditional wireline services for universal service purposes, and their ubiquitous availability, as indicated by the Staff and Verizon studies, demonstrates that supporting incumbent carriers through the creation of a fund is not necessary to ensure the continued existence of universal service.[81]

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[79] *See* the Universal Service Administrative Company website at www.lifelinesupport.org/li/tools/disbursements. (Lifeline disbursements to New York carriers can be identified by selecting "NY" as the State and using the "Find" button.) Among the carriers listed are Tracfone and Virgin Mobile.

[80] *See CDC Report* at 3 ("Adults living in poverty (39.3%) and adults living near poverty (32.9%) were more likely than higher income adults (21.7%) to be living in households with only wireless telephones.").

[81] In arguing that CMRS service is not an adequate substitute for traditional wireline service, NYSTA and Staff point to the Commission's December 17, 2010 "Order Adopting Verizon New York Inc.'s Revised Service Quality Improvement Plan with Modifications" in Case 10-C-0202, where the Commission noted that "[a]lthough wireless service continues to expand in New York and in some instances is a viable substitute for wireline service, [it] is not yet directly and seamless substitutable for *all* wireline service." (Page 15; emphasis supplied) *See* Tr. 75 (NYSTA Direct Testimony); Tr. 497 (Direct Testimony of Staff Substitutability Panel). However, that order addressed a narrow issue — the proposed definition of a group of "core" customers for a proposed service quality plan — and was not based on any detailed record (such as the one established in this proceeding) concerning the basis on which services should be classified for purposes of assessing the extent of universal service in the State.

The Commission's 1996 *Framework Order, supra*, put forward a list of the features and functionalities that were deemed to constitute the "basic service" whose ubiquitous availability was identified as the goal of the State's

(continued …)

C. GIVEN THAT A FUND IS UNNECESSARY TO PRESERVE UNIVERSAL SERVICE, THERE IS NO JUSTIFICATION FOR THE CREATION OF A FUND

In view of the many facilities-based competitive carriers that are ready, willing, and able to provide service in all areas of the State, it is unnecessary to create a fund in order to subsidize the business model of one particular group of providers, and protecting service providers or their investors from the financial consequences of competition is not a sufficient justification for the creation of a fund.

If the Commission concludes that there are legitimate financial interests of existing providers that need to be addressed, they should be dealt with through other Commission initiatives, or through Commission forbearance. For example, if the financial problems of the independents are attributable to legacy regulatory obligations, certainly those obligations should be relaxed or eliminated as responsibility for serving customers passes to the competitive market. The Commission should also be cautious about impairing existing revenue streams on which carriers have historically relied to support legacy regulatory burdens, where the associated rate levels are just and reasonable. Beyond these measures, a specific proposal for addressing the problems of financially-troubled telephone companies is presented in Section VIII of this brief.

(…continued)

universal service policy. Intermodal services provide all of those features on the list except for directory listings and operator services, which should no longer be considered necessary components of universal service. *See* Tr. 641-43 (Verizon Initial Testimony).

VI. CREATING A FUND WOULD HAVE A NUMBER OF UNDESIRABLE CONSEQUENCES

Verizon's testimony pointed to a number of respects in which the creation of a fund would have harmful effects that are clearly contrary to the public interest,[82] such as deterrence of competitive entry into rural ILEC service areas, the creation of inappropriate incentives for the funded companies, and the imposition of an unfair burden upon the contributing companies, thus impairing their ability to serve their own customers. In addition to being important in themselves, these impacts would also adversely impact universal service.

Many parties agree with Verizon's assessment. The Facility CLEC Coalition and Sprint highlight the same risks and potential harms.[83] T-Mobile notes the adverse impact on competition, as well as the risk that a fund could impair the affordability of service for customers who pay the contributions, citing the opinions of consumer advocates in other states.[84] We discuss these concerns in greater detail below.

A. DETERRENCE OF COMPETITION

The Staff and Verizon studies of the availability of competitive alternatives, discussed above, show that robust competition is present in virtually all areas of the State, except for a very small number of "white spot" areas. This demonstrates the importance of adopting measures that will provide incentives for competitive entry into the remaining white spots, and of avoiding measures that could deter such entry. Subsidization of incumbent providers through the creation of a new fund could further deter new entry and may even lead existing competitors to exit the

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[82] *See, e.g.,* Tr. 644-45, 730.

[83] Tr. 796-97.

[84] T-Mobile Direct Testimony (Ex. 87) at 14-16, 18.

market. Accordingly, the creation of a universal service fund would not only be unnecessary but would actually be counterproductive, since it would hinder competition, which is the best guarantor of universal service, price and service discipline, and innovation.

It should be noted that the problem of deterring competition cannot be addressed simply by providing similar levels of funding to competitive providers in any area in which funding is provided to an incumbent LEC. Such a "solution" would create significant public policy concerns of its own, as is illustrated by the widely-acknowledged problems experienced by the federal High-Cost Fund.[85]

CPB argues that a fund would actually support competition on a level playing field, in that "[l]ack of a fund could prevent the rural incumbent wireline carrier from competing on equal footing, as they are required to serve the entire service area while the newly certified cable and wireless service providers can chose to serve only the more lucrative portions of the service areas."[86] Although CPB is correct that regulatory disparities are a problem, creating a fund would simply add a second wrong in the hopes that the sum will be a right. Granting various forms of regulatory forbearance to incumbents would be a far better approach to the problem of asymmetric regulation.

B. CREATION OF INAPPROPRIATE INCENTIVES FOR FUNDED COMPANIES

The availability of funding based simply on a showing of financial need by an incumbent wireline provider would not solve the underlying problems that led to that need. Rather, it would

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[85] *See, e.g.,* 47 C.F.R. § 54.307; Federal Communications Commission, "Connecting America: The Broadband Plan" (March 2010) ("*National Broadband Plan"*), at 148 & nn.103-05 (labeling support of multiple competitive carriers for voice service in a particular area as "clearly inefficient"); *High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (rel. May 1, 2008).

[86] *See* CPB Direct Testimony (Ex. 89) at 10.

simply further delay resolution of the hard questions that incumbent companies need to confront — namely how, in a competitive market, those carriers can become self-sustaining without burdening competitors and their customers. The creation of a fund at this point would thus tend to create a class of permanently dependent providers — which is obviously a development that the Commission should not encourage.

The thorough analysis of the finances of the TF recipients by CTANY witness Richard Ansaldo — a former Section Chief in Staff's Office of Accounting and Finance — demonstrates that a fund is precisely the wrong solution to the NYSTA members' financial problems, because it will not eliminate, but rather will perpetuate and enhance, those problems.[87] As CTANY's testimony puts it, "[T]he availability of TF subsidies has provided a disincentive to innovate and lower costs."[88] Mr. Ansaldo's analysis thus confirms Verizon's position that companies should be required to consider changes in their way of doing business before asking other providers to support them through the creation of a new fund. Staff's Mechanism Panel also clearly recognizes this incentive problem.[89]

C. IMPOSITION OF AN UNFAIR BURDEN ON OTHER SERVICE PROVIDERS AND THEIR CUSTOMERS

Verizon suffers from its own formidable financial challenges in New York as a result of many of the same factors that are affecting the NYSTA members: legacy regulatory obligations,

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[87] *See* Tr. 331-32, 335-54, 358-59.

[88] Tr. 333.

[89] Tr. 539 ("If an incumbent company has done very little to become more cost efficient as competition intensifies, it would be unfair to allow it to draw from a fund, which includes contributions from companies that have taken steps to become more efficient, operating in other competitive areas of the state. As noted, as early as 1996, the Commission stated that its goal was for the ILECs to operate as though they were facing the consequences of competitive pressures.").

high fixed costs associated with the maintenance of a legacy network, and competitive inroads on revenues.[90] Four and a half years ago, in the *Competition III Order*, the Commission concluded that "[m]any consumers are taking advantage of [competitive] options and are reaping the benefits of technology and competition; as a result, former monopoly providers are losing customers, lines, usage, and revenues."[91] The Commission in that Order also recognized "the availability of real competitive alternatives and actual competitive gains that competitive carriers are achieving. These market forces are constraining incumbent prices and indeed are forcing incumbent prices down. This, in turn, reduces financial margins on previously more profitable products . . . ."[92]

These realities are reflected in Verizon's financial metrics. For calendar year 2009 (the year of Verizon's most recent Annual Report to the Commission):

- Verizon's intrastate return on common equity ("ROE") was negative 142.96%.
- Its total-company net income was negative $1.16 billion, and its total-company net operating income was negative $852.5 million.
- Its total-company cash flow from operating and investing activities was negative $1.02 billion.

These figures are not short-term anomalies, but part of a consistent, long-term trend that is documented in the financial metrics provided in Verizon's annual reports to the Commission for calendar years 2005 through 2009.[93]

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[90] *See* Tr. 646-53, 732-33 (Verizon Initial Testimony). The financial data in the following discussion is taken from this testimony.

[91] *Competition III Order* at 35.

[92] *Id.* at 54 (footnote omitted).

[93] Tr. 648.

The picture is not nearly so grim for the companies that are now seeking funding. For 2009, the net income of the regulated New York telecommunications industry as a whole — excluding Verizon — was positive $165.4 million, with total net operating income of positive $127.5 million. The net income of Class B telecommunication companies[94] was positive $34.8 million and their net operating income was positive $20.5 million. The ROE for the total industry excluding Verizon was positive 7.7%, and the ROE for Class B telecommunications companies was positive 5.8%.[95] This is not to say that some individual companies did not have low or negative values for some financial metrics in 2009. Nevertheless, it would clearly be unjust and unreasonable to look to Verizon to subsidize other companies whose key metrics are no worse than — and in many cases significantly better than — Verizon's own.[96]

This problem could not be adequately addressed even if Verizon were permitted to increase its existing rates — or to impose new end-user surcharges — in order to recover the amount of its contributions. Creating a surcharge would not solve the fundamental problems resulting from the creation of a fund. In addition, such a surcharge would not only harm consumers, but would also unfairly harm Verizon. Because New York has an extraordinarily competitive telecommunications market, Verizon may be unable to pass the contribution burden on to its own customers, in which case it would bear additional revenue losses. Thus, allowing Verizon to charge higher rates might merely convert a direct financial burden (*i.e.*, a funding

[94] Class B telephone corporations are those with annual revenues less than $100 million. 16 NYCRR § 661.1(a). The companies seeking draw-downs from a successor fund would presumably all fall within this group.

[95] *See also* Ex. 86, which tabulates ROE figures for Verizon and the NYSTA members.

[96] Indeed, as discussed previously, imposing such an obligation on Verizon would violate the paramount federal and state policies against taking without just compensation, as well as the policies underlying § 97 of the Public Service Law.

obligation) into an indirect one (*i.e.*, further diminution of revenues due to competitive losses). For this reason, there should be no mandate for any company to impose a surcharge.

The imposition of a fund-contribution burden on Verizon and other service providers should be a matter of intense concern to the Commission. Impairing the financial ability of the funding companies to invest and to serve their own customers would hardly advance the goal of universal service, as both the FCC and the federal courts have recognized.[97]

No party challenges the facts concerning Verizon's finances or makes any sort of cogent argument that it would be just and reasonable to compel a company to provide a financial subsidy to another company with a higher ROE. NYSTA's principal response is a *non sequitur*: "Verizon has elected to operate under an incentive regulatory plan, rather than rate of return regulation."[98] Why this would make it fairer to subsidize a company with higher returns by taxing a company with lower returns is left unexplained.

Various parties also argue that the burden on the funding companies would be *de minimis* — either because they would be able to pass it on to their customers (a contention that has already been discussed), or simply because not much money would be required to maintain the

[97] *See, e.g., High-Cost Universal Service Support* and *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337 and CC Docket No. 96-45, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd 4072 (rel. Apr. 16, 2010) ("*High-Cost Support Remand Order*"), ¶ 29. In upholding a cap on high cost support for Competitive Eligible Telecommunications Carriers, the United States Court of Appeals for the D.C. Circuit concluded last year that the FCC must exercise fiscal responsibility with universal service funding by "balanc[ing] the risks of excessive subsidization with the principles set forth in § 254(b)" and "consider not only the possibility of pricing some customers out of the market altogether, but the need to limit the burden on customers who continue to maintain telephone service." *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1102 (D.C. Cir. 2009). The court concluded that it was "entirely reasonable" for the FCC to "consider its interest in avoiding excessive funding from consumers." 588 F.3d at 1103. *See also Alenco Comms, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000); *Qwest Comms Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005).

[98] Tr. 191. In fact, Verizon is not currently operating under a formal alternative-regulation plan, although the manner in which it currently operates — without reliance on rate cases — can properly be described as incentive-based. (*See* Tr. 749-50).

fund. In fact, the estimates of the size of the fund vary widely. AT&T has proposed a $2 million fund; Staff estimates the size of the fund at $5.6 million per year; and NYSTA's estimate is $10 million per year.[99] Less important than these initial estimates, though, is the potential of each of the proposed funds to grow without restraint. Under AT&T's proposal, the fund would be allowed to double to roughly $2 million per year by 2013, but even this would not be a hard cap — it could be modified upon request. Neither Staff nor NYSTA recommend any sort of cap whatsoever. In fact, as noted earlier, NYSTA's proposed fund is designed to be "dynamic" in that it will grow automatically if costs increase, or revenues decrease. It is not farfetched to assume that like other programs that started small —the federal High Cost Fund is a prominent example — a state universal service fund would be susceptible to uncontrolled growth.[100] And, as discussed previously, the perverse incentives associated with funding would likely create an unending cycle of increased need leading to increased funding leading to reduced incentives to achieve financial self-sufficiency leading to another cycle of increased need and increased funding.

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[99] *See* Tr. 757-58, 766, 771-72 (AT&T proposal); Tr. 604-05 (Staff Policy Panel); Tr. 544, 546-48 (Staff Mechanism Panel); Tr. 103-05 & Ex. 19 (NYSTA).

[100] On cross-examination, NYSTA rather carefully stated that "*[b]ased on the 2009 numbers*, it [the fund] would not be more than $10.3 million." (Tr. 254; emphasis supplied.) However, later in the hearing NYSTA testified as follows: "**Q** . . . Pages 40-41 of your direct testimony, on those pages you state that your proposed fund will be handy to meet a whole host of potential regulatory changes and the state and federal level. Does this mean that the $10.4 million estimate in your testimony could be significantly higher over the term of this fund? **A** (Steve Watkins) The $10.4 million did not take into account any of these possible future changes." (Tr. 261.)

See also Tr. 295 ("There might be additional funding needed to address access, yes, that's entirely possible."); Tr. 297 ("[H]aving the mechanism in place may make it easier to address needs that might arise in the future"); Tr. 27-28 ("[The fund] structure proposed herein is sufficiently dynamic to allow the Commission to address future needs."); Tr. 60 ("[C]hanges in [support] mechanisms at the federal level may require some form of parallel changes in the intrastate arena. . . . Regardless, any implications with respect to universal service objectives including, most notably, the recovery of overall intrastate-allocated network costs across the available sources and resulting impact on the level and affordability of local service rates can be addressed more readily if a dynamic SUSF framework such as that suggested herein is already in place.").

D. POTENTIAL CONFLICTS WITH FEDERAL POLICY

Under Section 8.3 of the National Broadband Plan, the FCC proposes to adopt a "comprehensive reform program" that will re-purpose the federal High-Cost support program "from primarily supporting voice communications to supporting a broadband platform that enables many applications, including voice."[101] Ultimately, the proposal is to "end all financial support for networks that only provide 'Plain Old Telephone Service' (POTS)."[102]

The recommendations of the National Broadband Plan will be the subject of much discussion in the near future. The FCC has already begun to initiate the multiple universal service reform proceedings contemplated by the Plan. The Commission should be cautious about putting in place a new regulatory initiative that could fail to harmonize with — or indeed could even impair — federal efforts and policies in this area.[103]

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In sum, the creation of a fund would promote unfair and unreasonable outcomes, and would be inconsistent with the public interest. Accordingly, a fund should not be created. Instead, to the extent it becomes necessary to address the problems of financially-troubled ILECs

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[101] *National Broadband Plan* at 141.

[102] *Id.* at 143.

[103] *See In re State Universal Service Fund,* Docket No. NOI-08-2, "Order Terminating Inquiry" (Iowa Utilities Bd Aug. 25, 2010), at 2 (determining that the "federal reforms [proposed in the National Broadband Plan] make it difficult at this time for the Board to move ahead with its inquiry into the SUSF. It is not yet clear how the ultimate changes to the USF and ICC will affect Iowa consumers. Without more information about how consumers will be affected, the Board cannot determine whether an Iowa USF is appropriate and what level of support would be necessary to maintain universal service at reasonable rates for Iowa consumers. Further, the extent to which Iowa will mirror federal reforms by directing universal service support to broadband instead of voice service is not yet known. For these reasons, the Board concludes that its present inquiry into a SUSF should be terminated.").

(but only to that extent), the Commission should utilize the other alternatives that are discussed below.

There is no merit to the position that a fund should nevertheless be created as a precautionary measure, just in case the Commission should conclude at some point in the future that the need for funding outweighs the concerns outlined above. It is important to recognize that the creation of the fund would have many of the adverse consequences discussed above even before any determinations are made regarding the specific levels of funding that should be paid to particular providers. The mere existence of a fund may well hinder the expansion of competition in rural service areas, since it would send a message to competitive providers that the incumbent providers may be able to offer service on a subsidized basis.[104] By deterring the expansion of competition, a fund would thus undermine the goal of universal service rather than advance it. It would also send the wrong signals to the incumbent providers themselves, who will be less likely to undertake major structural changes in their business models — such as mergers and joint ventures aimed at achieving economies of scope and scale — if they believe that there is a significant chance that funding will be available to compensate them for any revenue requirement shortfalls. A fund could also impose upon the contributing companies a contingent obligation of uncertain magnitude, thus exacerbating their own financial burdens, which, in at least some cases, are more substantial than those faced by the potential fund recipients. Finally, creating a fund and

[104] *See Competition III Order* at 63 ("If rural rates more accurately reflect service costs, competitors may be able to extend their infrastructure and services to these areas. If nothing is done to adjust these subsidized rates, however, competition will be impeded and the benefits of intermodal services may be delayed or even denied in certain areas.").

keeping it in readiness would entail non-trivial transaction costs that would have to be borne by the industry (and, ultimately, by its customers).

Moreover, the "just in case" view presupposes that unless a fund is created in advance, the Commission will be unable to act to preserve universal service if and when a financial emergency arises for an ILEC. However, telephone companies have been through bankruptcies before, and bankruptcy courts have ample powers to protect such companies and ensure continuity of service during the pendency of the proceeding. For example, T-Mobile points out that ". . . ION's own history refutes the notion that preservation of a carrier's revenue streams is necessary to maintain its network functionality or service continuity. ION acquired its network when Empire, the rural ILEC consortium, declared bankruptcy. Neither Empire's bankruptcy, nor the transfer of its assets to ION, appears to have had any discernable negative effect on Empire or its customers."[105]

VII. FINANCIALLY TROUBLED ILECS SHOULD FIRST BE REQUIRED TO RAISE THEIR RETAIL BASIC SERVICE RATES TO A LEVEL ABOVE THE CURRENT $23 PER MONTH "BENCHMARK RATE"

A "benchmark" rate operates as a ceiling on the "just and reasonable rates" that a telephone company would be permitted to charge its customers for basic service.[106] Such a rate can play two different roles in relation to the funding process. *First*, a benchmark would limit the amount by which a provider would be permitted to increase its retail rates in order to avoid the need for funding. *Second*, if a fund is created, the benchmark would play a role in the rate-case process by which entitlements to funding are determined — in order to be eligible for funding, a

[105] T-Mobile Rebuttal Testimony (Ex. 87) at 7 (footnote omitted).

[106] "Basic" service is generally understood to include an access line and local calling. Generally, benchmark rates apply to residence customers, although some parties to this proceeding have proposed benchmark rates for business customers as well.

company would have to show that it could not collect sufficient revenue even if its basic service rates were raised to the benchmark level. In both respects, the higher the benchmark rate is, the less funding would be needed.

Currently, the Commission uses Verizon's statewide local-service flat rate of $23/month as the benchmark rate under the TF. As we show below, this benchmark is far lower than is necessary to ensure just, reasonable, and affordable rates that will permit the continued maintenance of universal service. Nevertheless, some potential fund recipients have not yet increased their basic rates even to this benchmark level.[107]

A number of parties agree with Verizon that the $23 rate is too low. AT&T, for example, argues that "the Commission should relax the current benchmark price cap, and it should set the benchmark price cap for local companies that seek fund support at up to the comparability cap of 125% of the Verizon urban rate."[108] CTANY testifies that "it is time for the Commission to reconsider whether the $23 benchmark rate, which was apparently below the actual cost of service for rural companies, should be eliminated or raised for the rural ILECs. When applied to rural ILECs, the $23 benchmark rate understates the cost of service and impedes competition by alternative providers."[109] The Facility CLEC Coalition "believes that the benchmark rate should be set at 10% above the Verizon New York Inc. or Frontier Communications of Rochester, Inc. rate for comparable service in the same geographic area," and that recipients should have an

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[107] *See* Tr. 721-22.

[108] Tr. 757 (footnote omitted).

[109] Tr. 755.

ongoing obligation to prove that the benchmark rate remains reasonable.[110] Sprint contends that, "[i]n practical terms, a 'reasonable amount' [for consumers to pay for basic local phone service] should mean *at least* the $23 benchmark . . . In fact, to reduce the burden on others, it would not be unreasonable to establish a higher benchmark."[111]

A. General Considerations Relevant to Setting a Benchmark Rate

The $23 benchmark was originally set in the *Competition III Order* as a maximum basic-service rate for Verizon, primarily based on a determination that such a rate would be reasonably cost-based and consistent with market prices. The Commission did not make any findings that higher rates would necessarily be unaffordable or would compromise universal service.[112]

There are sound reasons for making the benchmark rate for the rural incumbent LECs that are the focus of this proceeding higher than the Verizon rate. In the *Competition III Order*, the Commission identified a general policy of increasing basic service rates to cost in order to provide proper incentives for competitive entry.

> If rural rates more accurately reflect service costs, competitors may be able to extend their infrastructure and services to these areas. If nothing is done to adjust these subsidized rates, however, competition will be impeded and the benefits of intermodal services may be delayed or even denied in certain areas.[113]

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[110] Facility CLEC Coalition Direct Testimony (Ex. 88) at 12; *see also id.* at 10.

[111] Tr. 803 (emphasis in original; footnotes omitted). Staff testified that "[r]ural New York customers should not pay rates for local service that are substantially higher than those paid by customers in urban and suburban areas," but states that it cannot define a substantiality threshold "at this point." (Tr. 601-02.) Verizon's position is consistent with Staff's concern that rates in rural areas not be "substantially" higher.

[112] *See* discussion in *Competition III Order* at 53-64. *See also* Response to CTANY-DPS-2, and orders cited therein (copy provided as Attachment 2 to this brief).

[113] *Competition III Order* at 63. *See also id.* at 59 ("Rates below identified forward looking costs are not only anti-competitive, but they also suggest that rates are not even contributing to recovery of the costs of a hypothetical forward-looking network, let alone the one that actually exists.").

Furthermore, NYSTA itself concedes that its members are "high-cost" providers.[114] Thus, Commission policy would support a higher benchmark for predominantly rural carriers than for Verizon. Inflation provides another reason why the benchmark rates utilized in 2011 should be higher than the $23/month rate set five years earlier. NYSTA itself admits that inflation is a relevant factor in setting a benchmark rate.[115] Finally, Verizon agrees that the benchmark rate should be set at a level that is reasonably affordable. However, contrary to the positions of some parties, "affordable" rates are not necessarily identical to current rates or "lowest rates possible."[116]

Verizon's testimony offered two approaches to determining an affordable benchmark rate.[117] The first approach is based on the fact that the $23 rate represents a small portion of the median household income in New York. When the SLC and applicable fees, taxes, and surcharges are taken into account, a $23 monthly rate would correspond to a monthly bill of about $36-$37, depending upon the area of the State. According to Census Bureau data, the median household income in New York for 2008-09 was $50,243/year.[118] The Department of

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[114] *See, e.g.,* Tr. 257 ("**Q** . . . [G]enerally is it not your position that a universal service fund is needed to serve rural areas because these areas are higher cost, quote, higher cost, less dense areas? **A** (Steve Watkins [NYSTA]) That's one reason."); Tr. 33 (NYSTA refers to "the cost recovery challenges of network providers committing to service higher cost, less dense service areas"); Tr. 37, 41. *See also Competition III Order* at 45 ("Using forward-looking cost studies, the [Staff] White Paper also concludes that the cost of serving metropolitan areas is less than the cost of serving less densely populated areas of the state."). At Tr. 762, AT&T provides a tabulation of total unseparated loop costs for the independent telephone companies.

[115] *See* Tr. 114 (applying a 6% inflation factor to a 2009 rate).

[116] *See* CPB Direct Testimony (Ex. 89) at 9 ("Higher rates would undermine the principles of affordability and comparability of rates."); Tr. 473-74 (Direct Testimony of Staff Substitutability Panel) (referring to "a long-standing commitment to keeping basic residential service at the lowest rates possible").

[117] *See* Tr. 659-66.

[118] *See* http://www.census.gov/hhes/www/income/data/incpovhlth/2009/statemhi2_09.xls.

Housing and Urban Development projected 2010 statewide median family income of $55,300 for non-metro areas, which roughly corresponds to the areas served by smaller ILEC providers.[119] Thus, it seems reasonably conservative to use $50,000/year, or $4,167/month, as a reference income level.

A monthly bill of $36.50 represents less than 0.88 percent of this median household income. Certainly there is no basis for any claim that such a small percentage represents an absolute "affordability" ceiling. The FCC has determined that average household expenditures for telephone service (including the full range of wireless and wireline service) amount to over 2% of total household expenditures, or about $94/month as of 2008.[120] Clearly, reasonable increases in the amount allocated to basic service within this overall household telecommunications budget will not lead households to abandon their ability to communicate by telephone. Indeed, since most households currently have some form of cellular service, it is not surprising that households are becoming more likely to decrease their overall telecommunications budget — if they feel a need to do so — by "cutting the cord" and eliminating their wireline service altogether.

Verizon's second proposed approach seeks to determine the maximum rate that would be reasonably comparable to Verizon's $23/month rate. For this purpose, we looked to an FCC rule that establishes a test for comparing rates "in rural areas of the state served by non-rural

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[119] *See* http://www.novoco.com/low_income_housing/resource_files/income_limits/2010_medians.pdf.

[120] *See* Industry Analysis & Technology Division, Wireline Competition Bureau, FCC, "Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service" (2008), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284934A1.pdf) ("*Reference Book*"), Table 2.1 (expenditures on telephone service for 2006 [most recent year reported] represent 2.67% of total household expenditures for rural households, 2.21% for urban households, and 2.25% for all households). *See also* Industry Analysis and Technology Division, Wireline Competition Bureau, "Trends in Telephone Service" (September 2010), available at http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0930/DOC-301823A1.pdf), Table 3.1 (showing total household expenditures and telephone expenditures for 1981-2008).

incumbent local exchange carriers to urban rates nationwide."[121] Although the FCC test is not directly applicable here (since this proceeding does not focus on non-rural carriers providing service in rural areas), the test is nevertheless useful in that it provides a general criterion of "comparability." The maximum comparability level set under the FCC's rule is 143%.[122] Applying this factor to Verizon's $23 per month "benchmark" rate gives a comparable rural rate of $32.89 — or only a little over a third of the average total household expenditures for telecommunications referred to above.[123]

B. NYSTA'S PROPOSED BENCHMARK RATE

NYSTA, supported by CPB, argues that the $23 benchmark should not be increased — indeed, it should be lowered, to $15.22/month,[124] a rate that it bases on the FCC's recent calculation of the nationwide average urban local-service rate.[125] But there is no justification for setting *New York* rural rates based on an index of *nationwide* urban rates, as is shown by the fact

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[121] 47 C.F.R. § 54.316(a). While a "comparability" standard is not necessarily the same as an "affordability" standard, the principle behind the comparability requirement in the Act was to ensure that the benefits of competition in more densely populated areas would be shared in less populated areas. Therefore, a reasonable rate in urban areas provides a benchmark for what a reasonable rate is in more rural areas.

[122] *Reference Book*, Table 1.13.

[123] The benchmark level proposed by Verizon is not intended to address the needs of the poorest customers. However, those customers' needs will be adequately protected by the continued availability of Lifeline service, whether from the ILEC or through a modification to the TAF that would permit direct Lifeline subsidies for eligible customers, as proposed above. In addition, consideration for the needs of the poorest customers must also include an accounting for any added funding burdens placed on the contributing carriers' poor customers. The facile identification of "poor customers" with "rural customers" is simply not valid. For example, the county in the State with the lowest median household income is Bronx County, in which Verizon is the sole incumbent LEC. *See* Tr. 664-66.

[124] *See* Tr. 50, 113-19; CPB Rebuttal Testimony (Ex. 89), at 4-6.

[125] Tr. 113. This nationwide rate was $19.57 per month. NYSTA adjusted this 2006 rate for inflation ($20.74), backed out the federal Subscriber Line Charge and the Federal Universal Service Charge ($13.23), and then multiplied the resulting rate by 115%, which NYSTA explains as "the threshold that is currently used in determining federal HCL disbursements for rural ETCs." (Tr. 114.)

that the Commission-established New York benchmark is some 74% higher than NYSTA's adjusted urban local-service benchmark rate of $13.23.[126]

Of course, given the rates currently charged by the NYSTA Smaller ILECs, NYSTA is faced with the necessity of justifying a benchmark rate for its members that is lower than the comparable rate for Verizon, notwithstanding the fact that its members are concededly "high-cost" companies. It attempts to do so by arguing that the Verizon benchmark is wrong, and that the Commission ignored some elementary considerations when it set that rate in 2006.[127] As Verizon and Staff agree, that contention is simply incorrect.[128]

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For the reasons set forth above, the benchmark rate can be safely raised — and should be raised — to a level above $30/month. This will force providers seeking funding from other — perhaps competitive — providers to look first to their own retail customers to meet their financial needs.

VIII. ALTERNATIVES TO THE CREATION OF A NEW FUND ARE BETTER SUITED TO ADDRESS THE NEEDS OF FINANCIALLY TROUBLED ILECS

It has been suggested that financial support of troubled incumbent LECs is necessary in order to preserve functions essential to the maintenance of universal service, such as the provision of retail service in any "white spot" areas that might exist. However, the Commission should not

[126] It is not surprising that basic service rates would be higher in New York than in some other states, in view of the fact that this State was a pioneer in moving those rates from low, subsidized levels to more cost-based levels, in order to provide proper incentives for competitive entry. *See* text at footnote 113, above.

[127] *See* Tr. 116-19.

[128] *See* discussion at Tr. 727-30 (Verizon Rebuttal Testimony) and at Tr. 553-55 (Rebuttal Testimony of the Staff Mechanism Panel).

assume that these concerns can be addressed only by creating a fund and thereby inviting all of the harms discussed in the preceding sections of this brief. Instead, the Commission should carefully assess the existence, nature, and magnitude of the supposed problem, and should address it in the most narrowly targeted and efficient manner possible. Propping up an incumbent's entire financial structure in order to ensure continuity of service to 1% of its customers will rarely be the most efficient solution.

Verizon's initial testimony proposed a framework for addressing such issues.[129] Verizon's proposal was designed to ensure that before a financially-troubled LEC seeks support from other companies through the creation of a fund, the company itself would conduct a rigorous and disciplined review of alternatives that would enable it to address its own financial problems while continuing to provide all functions necessary to the maintenance of universal service within its existing service area — and would implement the most practicable, reasonable, and efficacious of the alternatives that it identifies. The Staff Mechanism Panel supports at least the underlying premise of the proposal by recognizing that an ILEC seeking support should be required to show that it has tried to solve its own problems.[130]

Such a proposal is not without precedent. The Commission has previously provided incentives to promote small water company mergers or acquisitions in order to achieve the benefits of economies of scale. The Commission did not mandate that the water companies take

[129] Tr. 657-67.

[130] *See* Tr. 539 ("If an incumbent company has done very little to become more cost efficient as competition intensifies, it would be unfair to allow it to draw from a fund, which includes contributions from companies that have taken steps to become more efficient, operating in other competitive areas of the state. As noted, as early as 1996, the Commission stated that its goal was for the ILECs to operate as though they were facing the consequences of competitive pressures.").

such steps, but stated that "[t]he guiding principal [sic] in granting acquisition incentives will be to increase customer benefit . . . To foster a transformation of small non-viable water companies into entities better able to serve, acquisition incentives may be provided in certain cases . . ."[131]

The first necessary step in such a review would be to determine the minimum set of services and functions that a company would need to provide in order to ensure the continued existence of universal service within the company's service area, giving due recognition to the availability of competitive alternatives.

Next, the company should review the measures it could take to achieve or maintain financial health while assuring that the identified services and functions will continue to be available. Such a review should be similar to the type of review that might be conducted by a consultant or investment banker advising a troubled company. All alternatives should be "on the table" for purposes of such a review, including alternatives that would make fundamental structural changes in the company's business model. Such structural changes might include the following:

- the sale or spin-off of a portion of the company's business;
- the outsourcing of particular functions; or
- mergers, acquisitions, joint ventures, and other transactions with other providers that might create economies of scope or scale.[132]

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[131] *See* Staff Response to CTANY-DPS-5; and Case 93-W-0962, "Statement of Policy on Acquisition Incentive Mechanisms for Small Water Companies" (issued and effective August 8, 1994), at 2-3. The "rational basis" for the Commission to impose a requirement for smaller ILECs who request universal service funding to demonstrate that they have considered all alternatives is at least as strong as the basis cited by the Commission in fostering "a transformation of small non-viable water companies."

[132] Staff's Mechanism Panel also recognizes the potential financial benefits of partnering with other ILECs. *See* Tr. 553.

We emphasize that because of jurisdictional limitations, the Commission would not be able to compel the company to adopt all — or perhaps any — of the alternatives identified in such a study. Clearly, however, it could decline to consider any funding proposal submitted by a company unless and until such a study is conducted and the Commission determines that no practicable, reasonable alternative to external funding would be consistent with the continued existence of universal service.

The alternatives considered in such a study would have to include an increase in the company's monthly retail basic service rate, as well as its other retail rates, to the highest just and reasonable levels. Such a rate ceiling would be determined in accordance with the methodology discussed above for the establishment of benchmark rates.

If as a result of the assessment process described above, a company proposes to withdraw from providing all or a portion of the regulated services that it currently provides pursuant to its tariffs and the Commission's common carriage regulations, then the Commission should limit the company's obligations accordingly. For example, if demand has declined to the point where it is not economic for a company to maintain facilities in the company's current service area, then the company should be freed of any obligation it may have under its existing tariffs to provide its own retail service in those areas. Also, a company should be given the right to de-average its rates to better reflect the cost characteristics of white spot areas, subject to the constraint of maintaining just and reasonable rates that will permit the continued existence of universal service in such areas. Aside from providing additional support for the filing company, such measures will stimulate competitive entry into areas currently classified as white spots.

The filing company would be required to provide notice of its study to all regulated telephone corporations in the State and to all intermodal providers that indicate their interest in receiving such notice. All would have the ability to review and comment on the study. Confidential information included in the study could be protected through the issuance of a protective order or through application of the Commission's existing FOIL regulations. The study would be reviewed by Staff based on its own expertise and in light of the comments of the parties. Staff would make a recommendation to the Commission as to the adequacy of the study.

NYSTA rejects the premise that its members should be expected to consider withdrawals from service areas or other structural changes in their business model in order to resolve their financial problems. Among its other contentions, NYSTA claims that ILECs need to be kept in business — presumably at their full current size — in order to provide backhaul and similar functions to intermodal providers.[133] But if it were true that the rural ILECs were integral to the operations of intermodal competitors, then one would expect those competitors to be strongly supportive of NYSTA's position in this case. Yet no intermodal competitor has spoken in favor of the creation of a fund, and several, including CTANY, T-Mobile, and Sprint, explicitly oppose it. Clearly, these competitors have weighed the harms from the creation of a fund against any harms that theoretically could result from the absence of a fund, and come down on the side of not creating a fund. Perhaps it is because they recognize that even if an ILEC should go out of business, its backbone network would undoubtedly be purchased by another provider.[134]

Moreover, as T-Mobile points out in its rebuttal testimony, an entity known as ION "is the owner and operator of 'an Albany, New York based, statewide, redundant SONET fiber network connecting over 60 rural New York State communities.'" As T-Mobile cogently notes, "The

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[133] Tr. 30.

[134] *See, e.g.,* Ex. 35; T-Mobile Rebuttal Testimony (Ex. 87) at 7.

presence of ION refutes the NYSTA Panel's assertions that funding the NYSTA Smaller ILECs is necessary to ensure the availability of backhaul services for wireless carriers and other alternative providers." Moreover, ION's network was built without support from a state universal service fund.[135]

IX. ISSUES RELATING TO THE OPERATION OF A FUND (IF A FUND SHOULD BE ESTABLISHED)

While Verizon does not believe that it would be either lawful or desirable to create a fund, Verizon offers the following proposals concerning the administration of a fund, if one should be established. These recommendations are not in any way an admission of the feasibility or lawfulness of a fund, and are made solely in response to the ALJ's direction that this issue be addressed in this proceeding.

A. SELECTING THE MOST EFFICIENT PROVIDER

Based on the lessons provided by the explosive growth of the federal high-cost fund, funding should be provided to only one company per location. That company should be the one that demonstrates that it is the most efficient provider of universal service in that location — that is, the company that would be willing, for the least amount of funding, to make its service available to any customers that do not already have adequate access to the services of other providers. Such a provider could be identified by competitive bidding or a similar mechanism.[136]

Bids should be solicited only for the services and areas identified as necessary for the maintenance of universal service (*e.g.*, white spot areas), and any viable company that is authorized under law to provide service should be permitted to bid.

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[135] T-Mobile Rebuttal Testimony (Ex. 87) at 1-7, 16 & Exs. 74-75.

[136] *See* Tr. 669-70 (Verizon Initial Testimony).

B. THE AMOUNT OF FUNDING TO BE PROVIDED SHOULD BE STRICTLY LIMITED

If competitive bidding or a similar mechanism is not utilized, and funding is provided only to the incumbent LEC, then a number of rules should be established to ensure that the funding arrangement: (a) is strictly limited to the maintenance of such specific services in such specific areas as are found necessary to advance universal service; and (b) will minimize unfairness to other companies and their customers.

First, applicants should have the burden of justifying their request for funding, and their applications should be submitted to strict scrutiny in open proceedings in which funding contributors, among others, have a full opportunity to participate.

Second, in all aspects of the administration of the fund, the Commission should recognize the fundamental principle that funding should be provided only to the extent necessary to ensure the continuation of universal service.

The assumptions governing rate cases — and in particular the assumption that a company is entitled to a level of revenue that will meet its "revenue requirement" — should not apply in funding determinations. Rather, the level of funding provided should be the minimum necessary to ensure the continuity of universal service, given, among other things, the availability of competitive alternatives. Moreover, this minimum should be determined on the assumption that the company seeking funding has raised or will raise its retail rates to the maximum just and reasonable level (determined in accordance with the preceding discussion), and that it has taken structural measures reasonably calculated to improve its financial picture. Of course, under this framework there would be no guarantee that the company would be able to recover its historical or "embedded" costs.

C. IDENTIFYING CONTRIBUTING COMPANIES

Only regulated service providers should be required to contribute to a fund (as is the case with the TAF). In particular, CMRS providers and VoIP providers (whether facilities-based or application-based) should be exempt from any contribution obligation.

There are a number of reasons for this. First, as already discussed, requiring contributions from wireless carriers would be precluded by Public Service Law § 5(6)(a). Second, intermodal providers are the most prominent — and in many cases, the only — competitors to the smaller incumbent LECs in their service areas. We have already discussed the unfairness of establishing a new fund that would require providers such as Verizon to pay subsidies to other carriers. The unfairness — and the adverse impacts on competition — would be multiplied if the entities that the Commission looks to for funding the operations of incumbent providers were their direct competitors.

In addition to those considerations, there is no public policy rationale for requiring new, innovative services — including wireless and VoIP — to help fund the chosen business models of other telephone companies. And that is particularly the case where there has been no demonstration that service would otherwise be unavailable or unaffordable, that alternatives to traditional wireline service do not exist, or that wireline carriers could not provide the service without such funds. The Commission should not burden new services and technologies (and the customers that use them) with legacy regulatory obligations that have outlived their usefulness, and with the associated costs of those obligations. Indeed, these service and technology innovations are spurring competition in the telecommunications marketplace, thereby providing an impetus for reduced rates in the traditional wireline sector. Burdening such services and customers with unnecessary new fees would simply punish their customers for choosing to use competitive services, and could drive investment dollars away from New York. Should the Commission choose to force wireless and VoIP providers to contribute to a fund, the result will be higher rates, the chilling of innovation, reduced investment, and fewer competitive options and fewer benefits for consumers. For all these reasons, the Commission should not hamper the continued growth of wireless and VoIP by imposing new fees on customers of these services.

The parties who support contributions from intermodal providers argue for this expansion of the current system largely on the basis that all providers benefit from having access to the largest possible pool of customers — including those of the upstate incumbent LECs — to communicate with. In economic parlance, the contention is that such LECs create "positive externalities," and that it is not unreasonable to require other providers to compensate them for the benefit that they create by keeping their customers on the network. However, this argument is becoming increasingly irrelevant in an environment where a substantial amount of calling has shifted to wireless networks.[137] Intermodal service providers create positive network externalities just as traditional voice providers do. The existence of such externalities thus provides no justification for a unidirectional flow of funds from intermodal providers to traditional wireline companies.

Furthermore, regulated companies that are themselves not earning a reasonable rate of return should not be required to contribute to a fund. As explained above, such a requirement would be inconsistent with fundamental fairness, with the Public Service Law and with the policies underlying it, and with the federal and State constitutions.

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[137] As Verizon and several other parties pointed out in initial testimony (*see* Tr. 637), more than 40% of American homes either had only a wireless phone or received all or almost all calls on wireless telephones despite having a landline.

D. ALLOCATION OF THE CONTRIBUTION OBLIGATION

Unless and until the FCC adopts a system other than one based on interstate revenues to fund universal service, this Commission should not, on its own, attempt to re-invent the wheel. In addition to the complexity of creating an entirely new funding mechanism for any state universal service fund, the burden on fund contributors to administer dual state and federal contribution systems would be significant. Thus, Verizon recommends the adoption of a system similar to that currently used for the TAF, in which contributions are based on regulated intrastate revenues.

However, if the revenue-based TAF mechanism is used as a model for contributions to any fund that the Commission should create, we would recommend one easy-to-implement change in that mechanism. Currently, TAF contributions are assessed on the basis of intrastate revenues net of intercarrier payments such as switched access, UNE, and resale charges.[138] The intercarrier payment offset should be eliminated, since it has the inappropriate effect of penalizing the provision of facilities-based service.[139]

Some parties advocate that contributions be calculated on the basis of phone numbers instead of revenues, but do not specify exactly how such a system would work.[140] AT&T points out that:

> While fund contributions could be assessed on a telephone-number basis (a proposal that AT&T generally supports and that the FCC may adopt), it

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[138] Cases 94-C-0095 and 28425, "Opinion and Order Establishing Access Charges for New York Telephone Company and Instituting a Targeted Accessibility Fund" (Op. No. 98-10) (issued and effective June 2, 1998), at 39-40.

[139] *See* Tr. 676. The Facility CLEC Coalition supports elimination of the intercarrier offset. Facility CLEC Coalition Rebuttal Testimony (Ex. 88), at 5.

[140] *See, e.g.*, Tr. 543-45 (Direct Testimony of Staff Mechanism Panel); Facility CLEC Coalition Direct Testimony (Ex. 88), at 9 (supporting a modified numbers-based scheme with adjustment for Enterprise customers).

> simply is not worth the time and expense to design and implement a contribution regime based on that methodology and to replace the existing contribution framework (which is assessed as a percentage of intrastate revenue).[141]

Beyond the point made by AT&T, while a number-based mechanism could possibly be advantageous if contributions were to be obtained from intermodal providers who do not track revenues by jurisdictional category — and thus do not have clearly-defined "regulated intrastate revenues" — such a mechanism would have less justification in the regime proposed by Verizon, in which no contributions would be sought from intermodal providers.

E. Recovery of Contributions Through End-User Surcharges

Carriers that are required to contribute to the fund should be permitted to recover their contributions through end-user surcharges. Although, as indicated above, such surcharges could adversely affect a carrier's competitive position — and therefore contributing providers should not be *required* to impose a surcharge — such providers should at least have the discretion to decide for themselves whether such a mechanism could mitigate the contribution burden. There is broad support from the parties for the surcharge option.[142]

F. Periodic Review

Verizon agrees with Staff's proposal for an "annual attestation" requirement under which any recipient "will be required to file an annual certification containing auditable financial and operational information with the Commission,"[143] although Staff's view of what type of

[141] Tr. 757 n.3.

[142] *See* Tr. 97-98 (NYSTA); Tr. 804-05 (Sprint); Tr. 544 (Staff Mechanism Panel); Direct Testimony of Facility CLEC Coalition (Ex. 88) at 9.

[143] *See* Tr. 543.

certification would be necessary is obviously tailored to the substantive funding requirements proposed by Staff, which differ from those proposed by Verizon.

G. SUNSET

A fund should sunset after a period of no more than two years, and the Commission's initial order establishing the fund should make it clear that no carrier should assume or rely upon the continued existence of the fund beyond that point. A sunset review will minimize service-provider reliance on the fund, and will thus create an incentive for structural changes that will enable a provider to move towards financial self-sufficiency. Moreover, technology, market structure, and regulation in the communications industry have changed rapidly in the last several years, and every indication is that such changes will accelerate in the future. As noted above, one important factor in this regard is the National Broadband Plan, which will undoubtedly have a profound effect on the need for and appropriateness of state universal service funding mechanisms. A sunset period will ensure that appropriate changes are made in the fund to reflect these external changes.

There is broad support among the parties for some sort of sunset arrangement.[144]

H. FUND ADMINISTRATION

The responsibility for administering a fund should be assigned through competitive bidding. Obviously, only neutral parties — *i.e.*, ones with no financial interest in contributing to or drawing from the fund — should be eligible to participate in such competitive bidding.

[144] *See* Tr. 766, 773 (AT&T); CPB Direct Testimony (Ex. 89) at 24; Tr. 804 (Sprint); Tr. 604 (Staff Policy Panel); Tr. 546 (Staff Mechanism Panel); and Facility CLEC Coalition Direct Testimony (Ex. 88) at 10.

I. FUND CAP

If a fund is created, in order to avoid excessive harm to the contributing companies, total fund payouts per year should be capped at the current size of the Transition Fund.

X. SUMMARY AND CONCLUSIONS

There is no need for the Commission to establish a fund to replace the TF. Competitive alternatives are present throughout the State and obviate the need to provide financial support to particular carriers who may not be the lowest cost providers in a particular area. In fact, a fund would interfere with the competitive process and would be a detriment to consumers and providers. It would also create inappropriate incentives for funded companies. Providers like Verizon, which themselves face severe financial challenges in this State, and which would be the primary contributors to a fund, should not be required to subsidize the business models of other carriers through a new fund. For these reasons, the Commission should reject funding proposals and instead implement non-fund solutions to the extent that some measures are deemed necessary to ensure the maintenance of universal service in the service areas of the NYSTA companies.

If the Commission decides, nonetheless, to create a fund, it should be targeted to the few, if any, remaining areas without competitive alternatives, should adopt strict rules relating to eligibility and to the amount of funding to be provided, should sunset after a fixed period of time, and should not burden new technologies, including wireless and VoIP.

Respectfully submitted,

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