

BEFORE THE HOUSE COMMITTEE ON ENERGY AND COMMERCE

**SUBCOMMITTEE ON COMMUNICATIONS,
TECHNOLOGY, AND THE INTERNET**

Hearing on H.R. 5828, “Universal Service Reform Act of 2010”

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TESTIMONY OF ROBERT STEVEN DAVIS

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Good morning Chairman Boucher, Ranking Member Stearns, and Members of the Committee. My name is Steve Davis, and I am Senior Vice President for Public Policy and Government Relations for Qwest Communications International Inc. Today I am here on behalf of Qwest Corporation, which operates as an incumbent local exchange carrier (ILEC) in fourteen mid-western and western states and Qwest Communications Company, LLC, which operates a long-haul long-distance network and one of the world's largest Internet backbones. I appreciate the opportunity to share Qwest's views on House Bill 5828, Universal Service Reform Act of 2010, a bill endorsed by Qwest, and reform of the federal universal service fund (USF) with you at today's hearing.

I. About Qwest and the CenturyLink/Qwest Merger

Before I address the bill and universal service issues directly, I would like to tell you a bit about Qwest and why these issues are so important to us. Qwest provides voice, data, Internet and video services nationwide and globally. Qwest provides service in Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming. Its service territory in these fourteen states encompasses 272,000 square miles. As of December 31, 2009, Qwest provided approximately 10.3 million voice grade access lines and approximately three million broadband lines to customers in its territory¹ and currently has broadband available to more than 85% of its customer base.

In April of this year, Qwest and CenturyLink announced their intent to merge the two companies. The merger is expected to close in the first half of 2011 and result in a

¹ Form 10-K of Qwest Communications International Inc., filed with the U.S. Securities and Exchange Commission, Feb. 16, 2010, at 2.

combined company that will provide voice and advanced telecommunications services in 37 states and operate a national 180,000 route mile fiber network. The post-merger company will have over 17 million telephone access lines and serve over five million high-speed internet customers. It is expected that the strong financial position of the combined company will enable it to make more investments to deploy broadband in the vast rural areas it will serve and push faster broadband speeds to more rural areas where there is a business case to do so. Even so, there will remain rural areas within the combined company service areas that will be uneconomic to serve without additional support.

Qwest's and CenturyLink's ILEC territories include many rural communities and areas of low household density. In many cases the low density areas the companies serve are also an extended distance from the nearest town. In areas of low household density, the companies experience low loop density and loops of extremely long length. In fact, Qwest has 175 wire centers with local loop density of fewer than ten access lines per square mile.² As an example of long loop lengths, in the wire centers of Douglas, Wyoming and Gillette, Wyoming, Qwest serves customers with local loops more than 75 miles long.

Qwest and CenturyLink are not alone. The extremely rural nature of many mid-sized companies' wire centers significantly increases their costs of providing basic local telephone service and broadband service in these rural areas relative to the costs for

² By contrast, within the Washington, D.C. city limits there are approximately 10,000 access lines per square mile. Washington, D.C. proper is 68.3 square miles. [http://en.wikipedia.org/wiki/Washington,_D.C.](http://en.wikipedia.org/wiki/Washington,_D.C) Verizon has reported 668,803 access lines in D.C. to NECA. The NECA file is available at the following link: <http://www.fcc.gov/wcb/iatd/neca.html>. The file from the 2007 Report is in the zip file USF08R07.zip and the file within the zip is USF2008LC08. The switched access line count for Verizon of DC is in cell R990.

providing these services in more urban areas. This is due to several factors. The low density of rural areas results in increased costs per customer access line as fixed costs are spread over fewer lines. And, the extremely long loop lengths result in significantly increased costs to place and maintain the physical plant from the central office to the customer's premises. Still further, for Qwest, the rocky and mountainous terrain as well as significant lake regions that are encountered in much of its ILEC region and in which it is harder to place and maintain physical plant, also drives up the cost of providing basic telephone service to customers in those areas. CenturyLink and other mid-sized carriers face similar challenges.

And, the companies face robust competition in providing communication services throughout their ILEC regions. In each state in Qwest's ILEC territory, state regulators have found that there is sufficient competition in the provision of telecommunication services to afford reduced regulation or full deregulation of those services. But that competition tends to be concentrated in more urban areas, thus leaving the obligation to serve the higher-cost rural areas to the ILEC.

These carriers frequently receive insufficient universal service support to provide service in these challenging conditions. Despite the extremely rural nature of Qwest's service territory, Qwest receives less than 1% of the federal funds allocated to support rural facilities deployments, and less than 6.7% of the federal funds allocated to non-rural companies. Although Qwest serves extremely rural areas in all fourteen of the states in its ILEC territory, Qwest only receives high cost support in four states: Montana, Wyoming, Nebraska and South Dakota.

Further, the high-cost funding that Qwest receives supports only voice services and does not support Qwest's broadband deployment activities. This is evidenced by the fact that Qwest's high-cost support is less than its total costs to provide, maintain and upgrade its facilities for voice services in the wire centers for which it receives high-cost support. Additionally, the FCC's non-rural High Cost Model, which develops forward-looking costs for determining the size of the non-rural fund, is based on a voice-service-only architecture, and thus calculates non-rural costs without including facilities necessary for broadband deployment.³ Qwest's use of its high-cost support is also consistent with the statutory requirement that all support received must be used "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." 47 U.S.C. § 254(e). Currently, broadband is not defined as a supported service under the existing high-cost mechanism.

II. Qwest Endorses the "Universal Service Reform Act of 2010"

First and foremost, Qwest commends Chairman Boucher and Congressman Terry for their leadership in addressing the much-needed reform of the universal service program. As Qwest has previously stated, we endorse Chairman Boucher and Congressman Terry's bill. Qwest supports not only the universal service reform provisions of the bill, but also the provisions addressing intercarrier compensation obligations.

A. Qwest Supports the Bill's Targeting of Universal Service High-Cost Support To Wire Centers and Sub-Wire Centers

³ In contrast, the rural high-cost loop fund is based on embedded costs and includes the costs of fiber loop and loop electronics that provide broadband services.

To the credit of its sponsors, the bill would allow for the targeting of federal high-cost support to wire center and sub-wire center areas. Qwest fully supports this approach.

Since its inception, the mechanism for distributing high cost support to “non-rural” carriers has been ineffective in distributing support and achieving the universal service goals of the Telecommunications Act of 1996. Any new mechanism for distributing high-cost support must not replicate the errors of that mechanism. The greatest flaw in the existing non-rural high-cost program is the use of state-level averaging to determine support.⁴ The current mechanism allocates high-cost support to “non-rural” carriers in each state based on whether the ILEC’s statewide average costs exceed a national benchmark. Even if a carrier serves several high-cost areas in a state, if its average costs statewide do not exceed the national benchmark, no high-cost support is available for that carrier in that state. As a result, today, many of the nation’s most sparsely populated communities served by “non-rural” ILECs like Qwest receive little, if any, federal high-cost support. At the local level, Qwest and other “non-rural” ILECs serve thousands of rural wire centers with very high costs -- as calculated by the FCC’s High Cost Model⁵ -- yet receive little, if any, explicit federal support for those wire centers. For example, Qwest serves Patagonia, AZ (model monthly cost \$127 per line), Deckers, CO (model monthly cost \$137 per line), Rose Hill, IA (model monthly cost \$162 per line), Comstock, MN (model monthly cost \$221 per line), and Leonard, ND (model monthly cost \$204 per line), but receives no federal high-cost support in any of these areas. Currently, the national average cost developed by the FCC’s cost model is

⁴ The rural program has the parallel flaw of using study area averaging and masking high-cost areas within the study area.

⁵ The High Cost Model is the model used to calculate the forward-looking costs of non-rural carriers used to determine high-cost support to those carriers.

\$21.43, and high-cost support is available where a non-rural carrier's statewide average cost per line exceeds two standard deviations of this national average, or \$28.13 (the national benchmark). Clearly, all of the costs noted above well exceed this national benchmark, but because statewide average costs – and not individual wire center costs – are measured against the benchmark, none of these wire centers receives federal high-cost support. There are hundreds of other examples of Qwest wire centers and those of other mid-size carriers with costs above the national benchmark where no federal high-cost support is received.

The current use of statewide average costs to allocate high-cost support assumes that low-cost urban areas can subsidize high-cost areas. But, competition today in urban areas does not allow support to flow to high-cost areas. In today's competitive marketplace, a different allocation method must be adopted to effectively and efficiently target high-cost support to high-cost areas. Thus, Qwest fully supports the bill's requirement that the new cost model for determining and distributing high-cost support should have the ability to calculate costs of and target support to wire center and sub-wire center areas. For each wire center, the model should also be able to distinguish the costs for the higher-density core area of the wire center from the less dense areas outside the core.

B. High-Cost Support for an Incumbent Provider Must Be Maintained Wherever An Unsubsidized Competitor is Not Offering Service

The bill also directs the FCC to implement a mechanism for reducing or eliminating high-cost support to incumbent carriers in areas where at least 75% of households can purchase voice and high-speed broadband service from an unsupported, facilities-based, non-incumbent provider. The premise that high-cost support should not

be offered to one wireline competitor where another unsubsidized wireline competitor extensively offers comparable services is reasonable. But, high-cost support must be provided for the higher cost areas where the unsubsidized competitor does not offer service. And, that support, which cannot be recovered through prices for supported services, must be provided consistent with the high costs to provide service to these customers..

Qwest agrees that developing a mechanism for evaluating the continued need of high-cost support in competitive areas is critical. Such a mechanism should help reduce inefficient use of high-cost support and re-direct those monies to more efficient uses such as broadband deployment to unserved areas or providing support to high-cost areas that currently receive no support due to state-wide averaging. Any process implemented should be a consistent approach that applies to high-cost support for both “rural” and “non-rural” carriers. Each step of universal service high-cost support reform should move away from the “rural” carrier versus “non-rural” carrier distinctions and move towards a consistent approach to support based on the nature of the area served.

As the bill drafters have recognized, under any approach for eliminating high-cost support where it is not needed, sufficient support is required for every customer location that does not have an unsubsidized wireline competitive alternative. Absent a demonstration by the petitioner that unsubsidized wireline providers offer service to every customer location in the high-cost area, high-cost support for the area should not be wholly eliminated. Otherwise, Congress and the FCC run the risk of unintentionally reducing universal access to critical telecommunications services in high-cost rural areas.

High-cost support must be provided to the sub-wire center areas that the unsubsidized wireline competitor does not serve.

C. Qwest Supports the Bill's Prohibition of Traffic Pumping.

Qwest strongly supports the bill's provisions prohibiting traffic pumping. The bill prohibits a local exchange carrier from recovering access charges where it has a business, financial or contractual relationship with an entity pertaining to switched access revenues generated from services that the entity is offering for "free" or below cost. Traffic pumping is a harmful and illegitimate scheme that is costing the communications industry and consumers millions of dollars each year. Qwest fully supports immediate steps to clearly legislate the illegality of these activities.

Traffic pumping arises from business relationships between small local exchange carriers (LECs) and providers of competitive non-regulated services such as conference calling and chat rooms. The scheme works like this. The FCC's current rules allow these small LECs (generally rural LECs) to tariff very high interstate switched access rates because the rules assume that the LECs will have low traffic volumes and high per unit costs. The LEC's business partner (often referred to as a "Free Service Provider" or FSP) offers the conference calling, chat room or other competitive services for free, with these services accessed via toll calls to numbers assigned to the small LEC. These FSPs are not actual customers, and do not order or pay for any telecommunications services from the LEC. The small LEC's traffic volumes skyrocket (often from a few thousand minutes per month to millions of minutes per month), its per-unit costs dive, and massive profits roll in from access charges paid by interexchange carriers ("IXCs"). The FSP finances its "free" operations via kickbacks from the LECs in the form of sharing of the high access

charges. To the extent that the LEC tariffs do not allow for charging switched access on traffic not destined for an end-user customer who purchases services, the traffic implicated in the traffic pumping scheme is not switched access, and the tariff does not apply. However, as traffic pumping LECs become more sophisticated, they are filing tariffs which include traffic to non-customers as eligible for switched access charges.

The scheme works because of several economic and regulatory quirks, the two most significant of which are:

- First, the small LECs' termination of toll calls to the FSPs is a monopoly service. Whether the LEC is an incumbent LEC or a competitive LEC, it terminates all calls to the numbers assigned to the FSPs. Thus, IXCs cannot avoid routing traffic to the traffic pumping LECs and cannot seek to deliver traffic via a LEC with reasonable access rates.
- Second, the FCC's rules prohibit IXCs from avoiding the LECs' excessive charges by refusing to deliver the artificially pumped traffic to the LECs.

It has been estimated that traffic pumping costs to the economy could exceed \$500 million if the problem is not addressed.

Last year, the Iowa Utilities Board determined that intrastate access charges generated by traffic pumping were unjust, unreasonable, and unlawful under Iowa law.⁶ Fundamentally, with the exception of the traffic pumping LECs themselves and their FSP partners, there appears to be universal agreement that traffic pumping presents a serious danger to the telecommunications structure, competition and public welfare.

⁶ In re Qwest Communications Corporation v. Superior Telephone Cooperative, (Iowa Utilities Board September 21, 2009), Docket No. FCU-07-2.

Proposals have been advanced to prohibit traffic pumping. This bill proposes simply prohibiting the assessment of access charges in situations where the LEC and a FSP have a revenue sharing arrangement and the competitive service is offered below cost. A recent proposal by a coalition of IXCs, including Qwest, and others (including a provider of conference calling service that does not rely on a traffic pumping scheme and thereby faces unfair competition from those that do), proposed a methodology to the FCC that would bring LEC rates to reasonable levels once certain levels of minutes were processed per month per line.⁷ The FCC's rulemaking on traffic pumping has been ongoing for almost three years, and resolution of traffic pumping is designated as an important part of the National Broadband Plan. The Plan identifies traffic pumping as an issue that should be addressed in the relatively near future, and Qwest agrees that rules should be implemented as soon as possible to prohibit traffic pumping activities. Qwest appreciates that the bill sponsors are addressing this serious issue and supports the bill's proposed solution to the problem.

D. Qwest Supports the Bill's Provisions Requiring Identification of Traffic and Requiring the Commission to Address Intercarrier Compensation Reform

Requiring all carriers to identify traffic that originates on their networks and requiring intermediate carriers to pass through that identification information is a critical step in effectively addressing the variety of phantom traffic issues that are the result of no identification or mis-identification of traffic being handled by multiple carriers.

Additionally, intercarrier compensation reform is desperately needed and a legislative mandate for the FCC to move forward and accomplish that reform may be the impetus

⁷ See Letter from Glenn T. Reynolds, Vice President Policy, USTelecom to Marlene Dortch, Secretary, FCC, WC Docket No. 07-135 (dated Aug. 31, 2010).

needed to jumpstart that process. Qwest is pleased that Chairman Boucher and Representative Terry have included these provisions in the bill.

E. Qwest Supports Universal Service for Broadband Services

In the National Broadband Plan, (Plan), the FCC estimates that 14 million people living in seven million housing units in the U.S. do not have access to terrestrial broadband infrastructure that can provide the Plan's target broadband service.⁸ Qwest agrees with Chairman Boucher, Congressman Terry, the FCC, and others that to accomplish the goal of universal availability of broadband service in the United States, it is time to explicitly and directly support broadband service, especially deployment of broadband-capable networks to unserved areas, through a modified universal service high-cost program. And, with the completion of the Department of Agriculture Rural Utilities Service disbursement of funds for broadband deployment under the American Reinvestment and Recovery Act, this is now even more critical. Universal service support is now the only remaining potential source of funding for broadband deployment to unserved and underserved areas. Qwest thus supports the bill's explicit authorization of universal service support for the provision, maintenance and upgrading of high-speed broadband service.

Reform is critical. The current high-cost program is already in need of significant repair and should be overhauled in order to explicitly and effectively support broadband-capable networks. Further, as the bill drafters have recognized, the current non-rural high-cost model is not designed to consider broadband network costs and in turn does not provide support that would enable non-rural providers to take on those costs in many

⁸ NBP, Chapter 8.1 at 136.

rural areas. To accomplish universal broadband service, new mechanisms that directly support broadband deployment to those areas must be designed and implemented.

And, there are other inefficiencies in the existing high-cost program that should be addressed and not perpetuated in reforming the program to support broadband. High-cost support to competitive carriers -- in areas that could not economically sustain one carrier -- has caused the fund to increase dramatically, while steering the fund well off its intended course of ensuring universal availability of essential communication services. Irrespective of whether it ever has, the high-cost program is not now providing support in a manner that effectively advances its fundamental goal of universal availability of essential communication services.

Congress and the FCC need to refocus high-cost support to broadband and voice services, target support to truly high-cost areas, and eliminate extraneous support so that, at most, not more than one provider of fixed service and one provider of mobile service is receiving support. To accomplish this, Qwest supports the bill's direction that the FCC develop a new cost model for calculating high-cost support that takes into account the cost of providing voice service and high-speed broadband service that would replace the existing methodology for rural and non-rural carriers. Additionally, Qwest supports the FCC's recommendation in the National Broadband Plan to establish a Connect America Fund (CAF) to support universal access to broadband and voice services, and believes there should be two CAF mechanisms: (1) a competitive bidding process to support broadband deployment to unserved areas and (2) a model for ongoing support of broadband and voice service in high-cost areas.⁹

⁹ For additional information regarding Qwest's views on this issue, see Qwest's comments filed July 12, 2010 in *In the Matter of Connect America Fund; A National Broadband Plan for Our Future; High-Cost*

As the bill requires, broadband universal service obligations, including carrier-of-last-resort obligations, should extend only to the area for which broadband universal service support is provided. Further, in designing the new distribution mechanism, the Commission should use *total* costs of providing *supported* services to determine ongoing support. In other words, all the costs of maintaining the network to provide voice services and broadband service at the targeted speeds and service quality level should be included. But, the costs of maintaining the network to provide broadband service at higher speeds and to provide video service should not be supported by the new fund.

But, in replacing existing support, Congress and the FCC must recognize that any sudden elimination of that support will significantly undermine those carriers' ability to invest in their networks. Before replacing existing support, the FCC must first design a new cost model for distributing support, and then a transition from legacy support can be determined. But, Congress should direct the Commission to promptly move forward with phasing out CETC high-cost program support that is not advancing universal service and refocus that support to effectively and efficiently promote access to broadband and voice services in high-cost areas.

The bill as currently drafted requires universal service fund recipients to offer broadband service at an FCC-determined minimum broadband speed throughout each service area in which it is receiving support within a specified time period either through the recipient's own infrastructure or through resale of satellite broadband services. But, as the bill drafters recognized, any obligation to deploy broadband service throughout a service area must be tempered by permitting reasonable technology and cost limitations.

Universal Service Support, Notice of Inquiry and Notice of Proposed Rulemaking, WC Docket Nos. 10-90 and 05-337, GN Docket No. 09-51, FCC 10-58, rel. Apr. 21, 2010.

Even with support for broadband deployment, certain areas will remain uneconomic to serve by wireline or wireless infrastructure. In those situations, a provider must be able to obtain a waiver of the service obligation. Thus, Qwest supports the bill's provisions authorizing a waiver of the requirement where offering broadband service would be technically or economically infeasible and authorizing an automatic waiver where a provider demonstrates that the cost per line of deploying broadband service is at least three times the nationwide average cost of providing the service.

F. Qwest Supports Reform of the Universal Service Contribution Methodology

The universal service contribution methodology needs to be simplified and restructured to better correspond with today's communication technologies and marketplace offerings. Because the marketplace has evolved to product offerings that often include packages and bundles of services providing interstate and intrastate telecommunications services and services that can be used as information services and/or telecommunications services, companies have had to adopt very complex administrative procedures to determine assessable interstate revenue. Further, the contribution factor, currently approximately 13% of assessable revenues, has become a significant fee for customers purchasing assessable services. It is also high enough to affect competitive pricing if one provider views a service as assessable and a competitor offering a similar service views that it is not assessable. Qwest thus supports the bill's providing the FCC with flexibility in designing a contribution methodology that will best resolve the myriad of problems with the current approach. In authorizing a broader base of contributors and the option to assess contributions on all communication service revenues, the bill gives

the FCC new tools that should greatly aid it in accomplishing effective contribution reform.

III. Conclusion

In drafting this bill, Chairman Boucher and Congressman Terry have provided Congress with a golden opportunity to adopt the successes and correct the errors of the current universal service high-cost program and structure a new and improved program for supporting universal access to basic telephone service and high-speed broadband service. And, they have proposed additional reforms to the universal service program and intercarrier obligations that should result in fairer responsibilities for customers and carriers alike. Qwest greatly appreciates the Subcommittee's attention to these issues and its continued efforts to accomplish this much-needed reform.

Thank you again for the opportunity to testify today on these important issues. I look forward to your questions.