

**TESTIMONY OF FCC COMMISSIONER AJIT PAI
COMMISSIONER, FEDERAL COMMUNICATIONS COMMISSION**

**BEFORE THE SUBCOMMITTEE ON COMMUNICATIONS AND TECHNOLOGY
OF THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE**

“CONTINUED OVERSIGHT OF THE FEDERAL COMMUNICATIONS COMMISSION”

JULY 28, 2015

Chairman Walden, Ranking Member Eshoo, and Members of the Subcommittee, thank you for giving me the opportunity to testify this morning. This hearing comes at a critical time. The agency is making policy judgments that will shape the communications landscape for many years to come. In particular, next week, the FCC is scheduled to make major decisions regarding the upcoming broadcast incentive auction. That’s where I will begin.

Incentive Auction.—I have serious concerns about how the incentive auction proceeding is being conducted. To begin with, the Commission has not been transparent enough. This is an exceedingly complex proceeding that requires the agency to make difficult technical decisions. And Congress gave us only one chance to get this right. It is therefore vital that stakeholders are given the necessary information in order to provide us with the feedback that we need to make the right choices. It is also vital that Commissioners themselves receive the data that we need to make informed decisions. But unfortunately, the Commission is falling short of meeting these standards.

For example, in early June, wireless carriers and broadcasters asked the Commission to disclose data regarding the results of six staff simulations of the initial clearing target optimization procedure proposed by the Commission last December. Instead of releasing this data promptly and giving stakeholders a meaningful opportunity to comment on the implications of the staff simulations, the FCC’s leadership stayed silent for over a month. But suddenly, just three business days before the July 16 FCC vote on the procedures for the incentive auction, the staff released some of the data, and the Chairman’s Office unilaterally waived the Sunshine period prohibition (though describing it as “the Commission[’s]” decision) so that parties could comment on the data until the night before the Commission meeting.

There were numerous problems with this approach. For one, the staff did not give stakeholders sufficient time to analyze the new data, attempt to replicate it, and supply the Commission with thoughtful feedback. And Commissioners did not have adequate time to review the comments that were going to be submitted. Moreover, the staff did not disclose all of the data that had been requested by broadcasters and wireless carriers. Given all this, I appreciate the leadership of Chairman Upton and Chairman Walden in calling on the Commission to postpone the July 16 vote on incentive auction procedures. Their intervention was critical to the decision to remove that item from our July meeting agenda.

Unfortunately, the process problems that led to that postponement have not yet been solved. Notwithstanding outside requests, the Commission still won’t release all of the data pertaining to the staff’s simulations. And again notwithstanding these requests, the Commission won’t conduct additional simulations. These are serious mistakes. We should not craft a future band plan based on only two simulations per clearing target and without making publicly available the data from those simulations. Instead, both Commissioners and interested parties should be able to evaluate the wide range of possible outcomes for each clearing target and see all of the relevant data.

For these reasons, I have heard numerous complaints that the Commission has not published enough information to allow the public to assess the validity of the arguments that Commission staff are making in favor of the Chairman’s proposals. And I also do not feel that I have been given enough

information to do the same. Right now, Commissioners are simply being asked to take on faith what we are being told, which is essentially that unless we adopt every aspect of the Chairman's proposals, the incentive auction will end in apocalyptic failure. But I, for one, prefer the Reagan approach: Trust but verify.

Moreover, Republican Commissioners continue to be shut out of the process. On July 8, I offered 10 substantive proposals to my colleagues that I believe will help improve the auction's chance of success. Commissioner O'Rielly has also offered thoughtful suggestions. But based on what little feedback I've received to date, it appears that the Chairman's Office is poised to reject virtually all of them.

This is an unfortunate partisan denouement to a process that began with your legislative consensus. It's important to remember that the FCC is empowered to conduct an incentive auction because of the bipartisan efforts in Congress, including within this Subcommittee. It's therefore disappointing that this Commission proceeding has been run in such a partisan manner. Time and time again, Commissioner O'Rielly and I have offered ideas for improving auction rules and/or procedures. Many of these ideas have been quite modest. Often, we receive no response at all. When we do receive a response, it's almost always the same: no. There is no reason why there should be a party-line divide on largely technical matters.

Turning to substance, the issue that's dominated the public discussion of late is the Commission's proposal to put broadcasters in the duplex gap. My position is clear: I oppose it.

However, I also believe that the proposal is the symptom of a larger problem with current incentive auction design. Specifically, the band plan that is on the table right now allows for too much variability and would put too many broadcast stations in the wireless portion of the 600 MHz band. This will impair spectrum slated to be sold in the forward auction and will cause interference between wireless and broadcast services. Following the 700 MHz auction, the Commission and industry were forced to deal for years with the problems created by having channel 51 television broadcast stations right next to A-block spectrum that had been sold to the wireless industry (not to mention the fact that the auction raised significantly less revenues because of these problems). I fear that the proposal that is now on the table, which would lead to co-channel and adjacent-channel interference, would make those problems look like child's play.

To be sure, we will need to allow for some band plan variability because of issues pertaining to the Canadian and Mexican borders. But the current proposal would permit far more variability than is necessary. Both wireless carriers and broadcasters have expressed serious concerns about that proposal and have taken the position that the Commission should minimize band plan variability. I agree.

The claim has been made that we must allow for substantial variability in order to have a successful incentive auction. But the Commission won't release sufficient data to demonstrate the truth of that assertion, and I seriously question whether it is accurate.

This is especially the case when there are common-sense solutions that would let us sidestep these pitfalls. For example, in order to reduce the need to place a large number of broadcast stations in the wireless portion of the 600 MHz band, we could offer broadcasters higher prices, thus enabling the Commission to purchase more spectrum. Or we could change the formula for setting a clearing target in order to choose a less aggressive number depending on the number of broadcasters volunteering to participate in the reserve auction. Either approach should enable us to put fewer broadcast stations in the wireless portion of the band.

Moreover, if we do put broadcast stations in the wireless portion of the band, I am extremely concerned that most of them will be placed in the most damaging place possible. Specifically, the data released by the Commission earlier this month revealed that most broadcast stations are slated to be put in

the downlink portion of the wireless spectrum, with some inserted into the duplex gap and a smattering in the uplink.

This plan flies in the face of the record that has been compiled by the Commission. Wireless carriers have told the Commission that it is better to place broadcast stations in uplink spectrum than downlink spectrum. Why?

First, as Cellular South told us, “mobile broadband providers currently require significantly more downlink than uplink spectrum to meet consumer demand.” That’s why, as T-Mobile explained, placing broadcasters in the “uplink will impair the less useful—and less valuable—segment of the band pair, which will increase the utility of remaining spectrum as well as the revenue generated by the forward auction, which will increase the total amount of spectrum cleared.”

Second, when broadcasters are placed in the uplink rather than the downlink, it is easier for carriers to minimize interference through the use of filters. When TV stations are repacked into the uplink portion, Verizon informed the Commission that “wireless operators can design market-specific base station receiver filters to protect against broadcaster interference.” And T-Mobile pointed out that these commercially available base station filters are “cost effective because the LTE base stations are fixed in location and limited in number.” By contrast, when broadcast stations cause interference in downlink spectrum, Verizon explained that “it is not possible to use market-specific filtering methodologies in handsets that must be able to roam all areas.”

For all of these reasons, placing broadcasters in the downlink spectrum rather than the uplink will make the spectrum sold in the forward auction less valuable. And placing broadcasters in the duplex gap will also cause downlink spectrum to be impaired. All of this will mean less revenue generated in the forward auction, which, in turn, will reduce the amount of spectrum the Commission is able to clear, and ultimately, the chances of holding a successful incentive auction.

The good news is that it isn’t too late to change course. Broadcasters and wireless carriers have proposed solutions to these problems. In my view, we need to listen and learn. That’s why I suggested that the Commission hold an *en banc* hearing at which all stakeholders could testify directly about these important issues. Rather than attempting to bully a seriously flawed band plan through the Commission on a party-line vote, we should do what Congress did when it passed the landmark incentive auction legislation: work together to develop a consensus solution.

Designated Entity (DE) Program.—The FCC’s DE program has been plagued by abuse. Even though the program is supposed to help small businesses, large corporations routinely try to game the system and gain access to discounted spectrum.

Who bears the cost of this abuse? Legitimate small businesses across the country—businesses that are actually building networks and serving their communities, like VTel Wireless in Vermont and Rainbow Telecommunications in my home state of Kansas. American taxpayers also take a hit since we all pay the price when corporate giants snag discounts Congress never intended them to have.

This made it all the more perplexing that the Commission voted this month to make it easier for big companies to profit from the program. In the wake of well-publicized abuses, we were promised FCC action to close loopholes that could be exploited by slick lawyers. Instead, the Commission reopened loopholes it closed on a bipartisan basis years ago—loopholes through which even minimally competent attorneys could drive a truck.

Specifically, the Commission paved the way for DEs to obtain a 35% taxpayer-funded discount on auctioned spectrum and then turn around and lease 100% of that spectrum to AT&T and Verizon. Such arrangements make a mockery of the DE program. Rather than increasing competition, they will increase consolidation in the wireless market. And rather than helping legitimate small businesses give

consumers an additional competitive alternative, they will give large carriers access to discounted spectrum.

Public interest advocates explained that allowing 100% leasing “would be terrible for taxpayers, who would be underwriting corporate welfare, and for consumers, who would not see valuable spectrum put to its most productive uses.” T-Mobile said that allowing 100% leasing “effectively would gut the purpose of the designated entity program” and “increas[e] the likelihood that designated entity benefits unfairly flow to ineligible entities or to speculators that acquire or warehouse spectrum at the expense of actual service providers that need it.” Still others remarked that allowing these leasing arrangements “will act like catnip to spectrum opportunists who are less interested in serving underserved areas than with getting rich quick at the public’s expense.”

Dozens of smaller and rural providers echoed these same concerns. Yet the Commission, on a party-line vote, made it easier for large corporations to abuse the program.

At the time, we were told that this change to our rules was designed to “reflect the realities of 21st century economic opportunity.” In some sense, that is sadly true. In the United States today, big businesses and those who are politically well-connected are often able to get ahead by manipulating the levers of the regulatory state to their advantage. Meanwhile, small businesses without Washington influence are left behind. The recent DE decision was yet another example of this.

We were also told that opening up new loopholes in our designated entity rules was “an attack on economic inequality.” I find this assertion to be baffling unless we are talking about reducing the gap between hedge-fund millionaires and hedge-fund billionaires. Let’s be clear: Those who will profit from the new loopholes are arbitrageurs and speculators who are already ensconced in the famed 1%.

Indeed, during the Commission’s deliberations on this issue, I made a simple proposal. Anyone making over \$55 million per year should be prohibited from owning a DE and getting a taxpayer-funded discount when purchasing spectrum. In my view, if your income is in the upper 8-digits, you are not exactly struggling and you certainly don’t need the public’s help. But the majority rejected this proposal. If the FCC truly believes the new DE rules are designed to be an “attack on economic inequality,” it’s strange that it affirmatively allowed those making more than \$55 million per year to benefit.

If we were serious about promoting economic opportunity, we would have adopted real reforms that would have stopped large companies from abusing the DE program and given legitimate small businesses a better chance to compete. That would have meant putting a meaningful limit of no more than \$50 million on the discounts that any single company could obtain in an auction. That would have meant putting a bright-line rule in place that prohibited large companies from setting up multiple DEs participating in a single auction. That would have meant strengthening our unjust enrichment rules to ensure that a shell DE couldn’t just flip its spectrum to one of our nation’s largest wireless carriers after a few years without having to repay its taxpayer-funded discount. And that would have meant preventing large companies from owning a majority stake in a DE to prevent them from siphoning taxpayer-funded discounts through shell companies.

Unfortunately, the Commission rejected these fact-based, common-sense, and widely supported reforms that would have restored public confidence in our DE program and put an end to abuse of the program. They will have to wait for another day.

Rural Broadband.—One of my top priorities as a Commissioner has been to extend digital opportunities to all Americans. And a month ago, while visiting Nebraska and Kansas, I had the privilege of seeing firsthand the opportunities that high-speed broadband can bring to rural America. For small towns, Internet access is critical to creating jobs, promoting entrepreneurship, and binding communities together.

For example, in Diller, Nebraska, a village of 287 people, I met with representatives of the Diller Telephone Company. Since 1899, the Diller Telephone Company has connected people in Diller and surrounding areas to the outside world. Most recently, it's done this by deploying fiber to the home or farm. The company's fiber network has been a boon to economic development in the area.

A great example is C&C Processing, a local meat processor. Thanks to the Internet, C&C has transformed itself over the past 20 years into a nationally known player. From a small, husband-and-wife grocery store and slaughtering operation in the mid-1990s, C&C now employs dozens of people. It sells meat at retail over the Internet and ships nationwide, and its wholesale products can be found everywhere from the PGA Tour to Whole Foods. Chad Lottman (a co-owner of C&C) can use an app to monitor his facilities remotely, and his team can now create electronic inspection records immediately available to the U.S. Department of Agriculture, instead of filling out reams of regulatory paperwork by hand. As Chad and his wife Courtney told me, Internet access, delivered by Diller Telephone, has truly made all the difference.

But when it comes to broadband, too many rural areas are being left behind. Four years ago, the FCC committed to reforming the Universal Service Fund to support broadband throughout rural America—a commitment that echoed the promise of the Communications Act itself to “make available, so far as possible, to *all* the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.”

Since then, we have made progress for rural Americans living in areas served by our nation's largest telecommunications companies, but we are failing those residing in areas served by the smallest. That's because of a quirk of regulatory history: Our rules governing small, rural carriers continue to provide universal service support only to networks that supply telephone service, not stand-alone broadband service. That regulatory system has increasingly come under strain as consumers flee landlines in favor of wireless and Internet-based (or “over-the-top”) alternatives.

Indeed, it has put some carriers to a Hobson's choice. On one hand, they can offer stand-alone broadband—which urban consumers have and rural consumers want—and lose universal service support. On the other, they can deny consumers the option of an Internet-only service, and risk them dropping service altogether (which they increasingly are). The net result is that rural carriers hold back investment because they are unsure if they can deploy the next-generation services that consumers are demanding.

It's time we made good on the promise of delivering broadband to rural Americans. That's why I put forward at the end of June a concrete and specific plan for correcting this historical accident and giving rate-of-return carriers a chance to participate in the Connect America Fund if they want to do so.

My plan is based on the principles set forth in a May letter to the Commission by 115 Members of the House of Representatives, led by Congressman Kevin Cramer. This letter, which was signed by 20 Members of this Committee, called on the FCC to adopt “an immediate, targeted solution” to the stand-alone broadband problem and to implement “a much simpler and straightforward plan” for rate-of-return carriers than was adopted for price-cap carriers.

That's exactly what my plan does. *First*, it implements a single page of changes to existing universal service rules to solve the stand-alone broadband problem. Specifically, my plan would include stand-alone broadband costs when calculating high cost loop support and interstate common line support. It would determine how much of that support should be attributed to stand-alone broadband. And it would direct that support be used to offset the cost of service. (My proposed changes to the rules are appended to the end of this statement.)

These simple amendments to our existing rules would have a big impact. They would allow rural consumers to choose broadband as a stand-alone service, and they would give carriers more assurance that arbitrary loopholes won't prevent them from meeting consumer demand. This will increase broadband deployment. They would also meet the FCC's own goals of distributing support equitably and

efficiently and ensuring no double recovery of costs. And they would do all of this within the existing budget.

Second, my plan creates a path so that rate-of-return carriers that want to participate in the Connect America Fund can do so before the end of this year. The FCC's staff have worked diligently to create an alternative cost model for rate-of-return areas (the A-CAM). The model might not be perfect—it wasn't initially designed for small, rural companies, for example. But that is no reason to prohibit participation on a strictly voluntary basis.

The path to permitting voluntary participation by the end of this year shouldn't be hard. In fact, there already appears to be a consensus on key points: Participation should be voluntary. The model should last for 10 years. Support should target unserved locations that will meet the Connect America Fund's 10/1 broadband benchmark. And FCC Form 477 data can form the basis of a streamlined challenge process.

I also believe that if a carrier's support would decrease under the A-CAM, a five-year transition period—two more than the FCC gave price-cap carriers—would be appropriate, and I believe there should be no limit on participation for such carriers. By contrast, if a carrier's support would increase under the A-CAM, numerous volunteers may swamp the rate-of-return budget. Therefore, I am open to using some of the reserves that have built up within the rate-of-return budget over the past few years to fund additional volunteers. But we must be fiscally responsible and prioritize participation for those areas that have the lowest build-out of high-speed broadband.

Earlier this year, in a hearing before the Senate Committee on Commerce, Science, and Transportation, every Member of the Commission committed to solving the stand-alone broadband problem by the end of this year. I believe that my plan presents a simple and straightforward path to accomplishing that goal and expanding broadband deployment in rural America. I look forward to working with my fellow Commissioners and the Members of this Subcommittee to get the job done.

AM Radio Revitalization.—Another area where FCC action is overdue is AM radio revitalization. Every day, it seems harder to get a good AM signal, and we see the impact in the marketplace. AM listenership is down, and advertising revenue along with it. Today, the AM band accounts for less than 20% of terrestrial radio listening in the United States.

That's why in 2012 I called for the FCC to launch an AM Radio Revitalization Initiative. It had been over two decades since the FCC had conducted a comprehensive review of its AM radio rules, and I believed that it was time for the FCC to modernize its regulations to provide AM broadcasters with badly needed relief.

In 2013, the Commission, under the leadership of then-Acting Chairwoman Clyburn, kicked off a proceeding on AM radio revitalization. We unanimously adopted a Notice of Proposed Rulemaking, which sought comment on a variety of ideas for revitalizing the AM band.

Specifically, we proposed a series of regulatory changes to help AM broadcasters address technical challenges, such as eliminating the ratchet rule, which stands in the way of AM stations improving their facilities. We also proposed opening a window for AM broadcasters to obtain FM translators. We know from experience that FM translators can deliver immediate and tangible help to AM broadcasters as we work on solving the band's long-term challenges. But there just aren't enough translators to go around right now. So the Commission proposed to give every AM station the opportunity to apply for its own FM translator.

Commenters provided nearly unanimous support for all of the proposals contained in the NPRM. Large and small broadcasters, civil-rights groups, and Democratic and Republican Members of Congress have all weighed in to support the Commission's approach. Among other things, they told the Commission about the continuing importance of AM radio. In communities across our nation, AM

broadcasters are at the forefront of providing Americans with local news and information, especially when an emergency strikes. And AM radio is also critical for diversity. Most minority-owned radio stations are found on the AM dial and foreign-language stations are also concentrated in the AM band.

Considering the stakes, the facts in the record, and the near-unanimous bipartisan support, I'm disappointed that, almost two years after the FCC kicked off the AM radio revitalization process, the agency hasn't delivered. In fact, we haven't even been given an order to vote on. To be sure, I was pleased to see FCC leadership promise, during the NAB Show in April, that "in the coming weeks" we would see a "Report and Order that will buttress AM broadcast service and ease regulatory burdens on AM broadcasters." But three-and-a-half months have gone by since that statement, and nothing has happened.

I don't understand why it is taking so long for the Commission to move forward on this critical issue. It's certainly not the fault of the staff in the Media Bureau's Audio Division, whose efforts I deeply appreciate. They have worked tirelessly over the past few years on this matter. It is my understanding, for example, that the Audio Division provided a full draft of the order to the Chairman's Office *last year*.

A bureaucracy that springs into action to overregulate markets that haven't failed, like over-the-top video, shouldn't snooze when it comes to markets that actually need our help, like AM radio. I hope that the Subcommittee will urge the Commission to move forward with the AM revitalization proceeding soon. Time is not on the side of the grand old band, and there is no excuse for further delay.

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Chairman Walden, Ranking Member Eshoo, and Members of the Subcommittee, thank you once again for holding this hearing and inviting me to testify. I look forward to answering your questions, listening to your views, and continuing to work with you and your staff in the days ahead.

APPENDIX

Targeted Rule Changes to Support Stand-Alone Broadband

Add 54.303 to read:

§ 54.303 Stand-Alone Broadband Support

(a)

(1) Expense attributable to C&WF subcategory 1.2 investment in stand-alone broadband transmission service facilities and expense attributable to C&WF category 2 investment in stand-alone broadband transmission service facilities shall be treated as expense attributable to C&WF subcategory 1.3 investment for purposes of calculating high cost loop support pursuant to § 54.1310 and interstate common line support pursuant to § 54.901 through 54.904.

(2) Expense attributable to Exchange Line CO Circuit Equipment category 4.11 investment in stand-alone broadband transmission service facilities and expense attributable to Exchange Line CO Circuit Equipment category 4.12 investment in stand-alone broadband transmission service facilities shall be treated as expense attributable to Exchange Line CO Circuit Equipment category 4.13 investment for purposes of calculating high cost loop support pursuant to § 54.1310 and interstate common line support pursuant to § 54.901 through 54.904.

(b) C&WF loops used for stand-alone broadband transmission service shall be treated as working loops (or lines) for each study area for purposes of calculating high cost loop support pursuant to § 54.1310, interstate common line support pursuant to § 54.901 through 54.904, and the monthly per-line limit on universal service support pursuant to § 54.302.

(c) A study area's stand-alone broadband support shall equal the lesser of:

(1) the sum of the amounts calculated pursuant to § 54.1310 and § 54.901 through 54.904 (as adjusted pursuant to § 54.302) multiplied by the ratio of C&WF loops used for stand-alone broadband transmission service over the number of working loops as determined for calculating high cost loop support pursuant to § 54.1310, or

(2) the sum of the amounts calculated pursuant to § 54.1310 and § 54.901 through 54.904 (as adjusted pursuant to § 54.302) minus the interstate common line support calculated pursuant to § 54.901 through 54.904 (notwithstanding the provisions of this section).

(d) The expense adjustment for purposes of § 54.1301(a) shall equal the sum of the amounts calculated pursuant to § 54.1310 and § 54.901 through 54.904 (as adjusted pursuant to § 54.302) minus the sum of stand-alone broadband support calculated pursuant to § 54.303(c) and interstate common line support calculated pursuant to § 54.901 through 54.904 (notwithstanding the provisions of this section).

(e) The annual revenue requirement for the interstate Special Access element for a study area shall be offset by an amount equal to that area's stand-alone broadband support.

(f) Every non-price cap incumbent local exchange carrier must provide the National Exchange Carrier Association with the information necessary to carry out the provisions of this section.

(g) This section shall be effective beginning July 1, 2016.

§ 54.1301 General

Effective July 1, 2016, amend section 54.1301(a) to replace the phrase "this subpart M" with the phrase "§ 54.303(d)".