

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92

**COMMENTS  
of the  
NATIONAL EXCHANGE CARRIER ASSOCIATION, Inc.;**  
**NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION;**  
**ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL  
TELECOMMUNICATIONS COMPANIES; and**  
**WESTERN TELECOMMUNICATIONS ALLIANCE;**

**CONCURRING ASSOCIATIONS\***

California Independent Telephone Companies	Oregon Telecommunications Association <sup>2,3</sup>
Colorado Telecommunications Association <sup>2,3</sup>	Rural Arkansas Telephone Systems
Idaho Telecom Alliance <sup>3</sup>	Rural Iowa Independent Telephone Association
Illinois Independent Telephone Association <sup>3</sup>	Rural Telephone Management Council
INDATELgroup <sup>TM</sup>	South Dakota Telecommunications Association
Indiana Exchange Carriers Association	State Independent Telephone Association of Kansas <sup>3</sup>
Iowa Telecommunications Association <sup>2,4</sup>	Telecommunications Association of Michigan <sup>2</sup>
Kansas Fiber Network	Telecommunications Associations of the Southeast <sup>2,5</sup>
Kansas Telecommunications Industry Association	Telephone Association of Maine <sup>3</sup>
Minnesota Independent Coalition <sup>2</sup>	Telephone Association of New England <sup>3</sup>
Minnesota Telecom Alliance <sup>2</sup>	Telephone Association of Vermont <sup>2</sup>
Montana Independent Telecommunications Systems	Tennessee Telecommunications Association
Montana Telecommunications Association <sup>2</sup>	Washington Independent Telecommunications Association <sup>2,3,4</sup>
National Tribal Telecommunications Association	Wisconsin State Telecommunications Association
New Hampshire Telephone Association <sup>3</sup>	Wyoming Telecommunications Association <sup>2</sup>
North Dakota Association of Telecom Cooperatives	
Oklahoma Telephone Association <sup>1</sup>	

\*Concurrence by marked associations does not include the participation or concurrence of one or more member companies as identified by numeric code: (1 = AT&T, 2 = CenturyLink, 3 = FairPoint, 4 = Frontier, 5 = Windstream).

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## *Summary*

The national, regional and state rural telecommunications associations listed on the cover page of these comments (collectively, the “Rural Associations”) join together to offer a responsible approach to reform of today’s Universal Service Fund (“USF”) High-Cost program and Intercarrier Compensation (“ICC”) mechanisms for rural rate-of-return incumbent local exchange carriers (“RLECs”) (“the RLEC Plan”). The RLEC Plan will ensure that high-quality, affordable, and “reasonably comparable” broadband services are available throughout RLEC service areas. Moreover, it accomplishes this in a manner consistent with the four principles for USF and ICC reform enumerated in the instant Notice of Proposed Rulemaking (“NPRM”).

The Rural Associations and their members strongly support the need for reform, but respectfully disagree with the presumption in this proceeding that universal broadband deployment – “the great infrastructure challenge of the early 21<sup>st</sup> Century” – can ultimately be accomplished without expending additional funds over time. To the contrary, it is becoming increasingly apparent the goal of maintaining USF funding at existing levels simply cannot be squared with the objectives of the National Broadband Plan (“NBP”) to promote and ensure the ubiquity of high-quality, affordable broadband, nor will it enable the Commission to satisfy the statutory requirement to preserve *and advance* universal service. In these comments, the Rural Associations renew their call for prompt reform of the USF contribution methodology as a way of resolving this fundamental conflict.

The Rural Associations do agree, however, that there is an unmistakable need to orient the USF toward broadband-capable networks and ensure affordable end-user rates. There is also without question a need to modify certain of the existing universal service mechanisms to enhance performance and improve sustainability. But such changes must be surgical and

deliberate. Even with the staged approach described in the NPRM, as demonstrated herein, many of the Commission's proposals will, if adopted, dramatically undermine universal service in rural areas served by RLECs and put at risk substantial investments made pursuant to and in compliance with current rules.

To avoid these results, and to serve both the underlying statutory objectives of universal service and the fundamental pillars of reform identified in the NPRM, the Rural Associations offer in these comments more measured and reasonable alternative approaches to USF and ICC reform for RLECs. The RLEC Plan incorporates four important steps consistent with the NPRM's staged approach to reform.

**1. Near-Term ICC Reform:** As a first step for *any* ICC and USF reform plan, the Rural Associations urge the Commission to immediately address long-standing disputes involving application of ICC rules to interconnected Voice over Internet Protocol ("VoIP") services, call signaling requirements, access stimulation, and non-payment issues. The Rural Associations strongly support prompt action on the issues discussed in section XV of the NPRM consistent with their comments filed April 1, 2011.

**2. Near-Term USF Reform:** To address Commission concerns regarding alleged inefficiencies in the current cost recovery framework for rate-of-return ("RoR") carriers, the Associations propose several carefully-targeted measures designed to constrain, reasonably, the recovery of RLEC capital investments and operational expenditures from federal universal service mechanisms on a prospective basis. At the same time, these constraints would avoid harming rural consumers or undermining broadband deployment efforts and the continuing availability and affordability of services in rural America. Specifically, the Rural Associations recommend the Commission:

- Impose a limitation on federal USF recovery of prospective RLEC capital expenditures based on analyses of booked study area costs, to determine the portion of a carrier’s loop plant that has reached the end of its useful life and should be eligible for replacement; and
- Cap recovery of corporate operations expenses via federal USF by applying the current High-Cost Loop Support (“HCLS”) corporate operations expense cap formula to Interstate Common Line Support (“ICLS”) and Local Switching Support (“LSS”).

These two steps, described in detail in these comments, will address expressed concerns regarding recovery of costs under today’s rural High-Cost program and help to constrain growth in the size of the fund, without the dramatic adverse impacts associated with certain of the near-term proposals described in the NPRM as demonstrated herein. Moreover, as described below, existing HCLS and ICLS funding will phase out under the RLEC Plan, as support transitions to a new longer-term RLEC-specific broadband funding mechanism designed to function as a component of the overall Connect America Fund (“CAF”). An approach for transitioning LSS into the CAF is discussed herein in connection with proposals for implementation of ICC reform.

**3. Longer-Term ICC Reform:** The RLEC Plan seeks to achieve sustainable ICC reform by first setting up a process to unify intrastate and interstate switched access rates by company. However, a critical component of this transition is that ICC rate reductions be coupled with a sufficient restructure mechanism (“RM”). Failure to enable RLECs to recover their lost access revenues would severely impact their ability to transition to an all-IP network with ubiquitous broadband availability, as the NBP envisions, and will prevent many from repaying outstanding loans, meeting current payrolls, fulfilling critical Carrier of Last Resort (“COLR”) responsibilities, and simply maintaining existing network plant.

ICC reform should permit RLECs’ interstate and intrastate switched access rates to be unified with intrastate rates on a carrier-by-carrier basis at the discretion of state commissions and should not mandate “bill and keep” or any uniform rate applicable to all carriers. The Rural

Associations instead recommend taking ICC reform in sensible, well-defined stages, starting with unification of intrastate and interstate access charges, followed by subsequent “pause points” along the way to allow the Commission and the industry to take stock of market developments, technological advances, and regulatory needs that will help inform how further reforms should be structured and implemented. Approaches for transitioning LSS into the CAF should be considered as part of overall ICC reform.

**4. Longer-Term USF Reform:** Finally, the RLEC Plan contemplates development of a cost-based, “evolved” RoR-based broadband funding mechanism for RLECs that operates as a separate but complementary component of a more far-reaching CAF. A distinct RoR-specific CAF mechanism is justified for RLECs, as these carriers uniquely serve as “carriers of last resort” to very sparsely-populated areas extending over 40 percent of the nation’s land mass, where there is little if any independent business case for investment or ongoing operations of networks. This “evolved RoR” component of the larger CAF would operate in summary as follows:

- a. The RLEC CAF component starts with current interstate costs computed under the Commission’s existing rules, subject to the additional constraints on recovery of costs from federal USF mechanisms discussed above, as part of near-term USF reform. The RLEC Plan would then add support for certain costs associated with “middle mile” facilities and access to the Internet backbone, as these facilities represent a crucial link in the broadband provisioning chain.
- b. The Commission (in cooperation with a Federal-State Joint Board) would revise its separations rules to allocate certain additional “last-mile” loop costs to the interstate jurisdiction based on individual company broadband adoption rates. This approach will create additional incentives for RLECs to promote broadband adoption among their customers. Also, as noted above, this separations adjustment will allow existing HCLS to phase out as customers adopt broadband.
- c. Based on costs determined using the methods described above, an RLEC would receive CAF support for broadband transmission costs first by computing its Broadband Network Transmission Costs and then subtracting revenues based on an urban benchmark (the “Benchmark”) designed to represent the costs of providing reasonably comparable wholesale broadband transmission services in urban areas.



- d. The RLEC Plan also contemplates a transitional ICLS component, to assure continuation of service to customers that have yet to adopt broadband and are obtaining only local exchange voice services. Such transitional ICLS would decline as more customers subscribe to broadband and would be eliminated once all customers have migrated to broadband-based network services.
- e. Subtracting RLEC CAF support amounts as determined above from interstate revenue requirements yields residual cost amounts, for recovery via a combination of end-user and other customer charges. As the broadband marketplace and services evolve, these rate structures are expected to evolve as well.

The Rural Associations estimate that the total increase in disbursements over time under the combined RLEC USF/CAF mechanisms (excluding RM amounts associated with ICC reform) will be comparable to (and likely somewhat less than) outlays under existing mechanisms, which have been growing at a modest 2.5 to 3 percent annual rate as broadband services are extended to rural consumers. **That is, after adjusting for likely inflation, RLEC High-Cost program costs should remain approximately the same as under existing rules.**

This support structure, however, hangs on a delicate and carefully arranged balance. Attempting to build and sustain “a broadband world” on the back of funding levels that have been primarily calibrated to support a narrowband network is a very difficult proposition, and the RLEC Plan has been carefully designed to ensure that the benchmarks, cost allocations, and ultimate recovery mechanisms will (i) sustain broadband-capable networks in high-cost areas where they exist today; (ii) provide a reasonable opportunity to recover the costs associated with existing investments; (iii) promote the responsible “edging out” of broadband into unserved areas at a reasonable pace; and (iv) control growth in the fund. If, however, the Commission “tinkers” with the benchmarks or other mechanics of the reform proposals, if it fails to provide adequate support for recovery of existing investment made under current rules, or if it fails to provide sufficient support for the task of both delivering and keeping broadband in rural America, the

Commission runs the substantial risk of frustrating efforts to push broadband into unserved areas and would also place at risk the ability to sustain existing network investments.

Since cost and deployment estimates – as well as technology and market developments -- are necessarily subject to change, the Rural Associations recommend the Commission plan an additional proceeding approximately three to five years following initial implementation of this longer-term CAF component and associated ICC reforms to examine both program cost trends and deployment/adoption results and assess the need for further modifications to the RLEC Plan.

The RLEC Plan satisfies both the Commission’s near- and long-term goals in this proceeding. In the near term, the targeted reforms described in these comments encourage fiscal responsibility, demand accountability, constrain growth in USF, and modernize existing mechanisms – without the dramatic adverse impacts that are likely to arise under certain of the near-term rule revisions proposed in the NPRM.

The Rural Associations do support, however, near-term proposals to phase-out existing “identical support” for competitive eligible telecommunications carriers, streamline the study area waiver process, and revise section 54.305 of the Commission’s rules (the “parent trap” provision) subject to certain modifications. These proposals will serve the purposes of promoting greater efficiency in operations and ensuring that broadband services become *and remain* available throughout rural America.

Longer-term, the RLEC-specific CAF mechanism provides a method for determining RLEC support that is more legally-defensible and far safer than reliance on reverse auctions or cost models. As discussed herein, these proposals fail to recognize the important role RLECs play as COLRs within their rural service areas. Indeed, several aspects of the Commission’s proposed “Phase I” CAF mechanisms are problematic and should be revised as discussed below.

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## I. INTRODUCTION

The national, regional and state rural telecommunications associations listed above the “Rural Associations”), collectively representing all rural rate-of-return (“RoR”) regulated incumbent local exchange carriers (“RLECs”) in the United States, join together in these comments to express strong support for responsible reform of today’s Universal Service Fund (“USF”) High-Cost program and Intercarrier Compensation (“ICC”) mechanisms.<sup>1</sup>

Our members recognize that changes are needed to existing high-cost USF and ICC rules. There is an unmistakable need to orient the USF toward more express support of broadband-capable networks and affordable end-user rates, and there is without question a need to modify certain of the existing mechanisms to enhance their performance and improve sustainability. But the future of broadband is far too important for experimental attempts at reform. This means that the Federal Communications Commission (the “Commission”) should seek to retain approaches and mechanisms that have worked with substantial success to encourage the deployment of broadband-capable networks in RLEC areas to date, while modifying these mechanisms as necessary to enhance certain aspects and orient them toward a broadband environment.

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<sup>1</sup> The National Exchange Carrier Association, Inc. (NECA) is responsible for preparation of interstate access tariffs and administration of related revenue pools, and collection of certain high-cost loop data. *See generally*, 47 C.F.R. §§ 69.600 *et seq.*; *MTS and WATS Market Structure*, CC Docket No.78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983). The National Telecommunications Cooperative Association (NTCA) is a national trade association representing more than 580 rural rate-of-return regulated telecommunications providers. The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) is a national trade association representing approximately 470 small incumbent local exchange carriers (ILECs) serving rural areas of the United States. The Western Telecommunications Alliance (WTA) is a trade association that represents over 250 small rural telecommunications companies operating in the 24 states west of the Mississippi River.

The Commission’s decision to bifurcate its proposed reforms in the above-captioned Notice of Proposed Rulemaking (“NPRM”)<sup>2</sup> into near-term and long-term stages is encouraging in this regard, reflecting an apparent desire to take a more deliberate and measured approach to reform.

Unfortunately, even with this staged approach, a number of the proposals outlined in the NPRM will, if adopted, dramatically undermine universal service in rural areas served by RLECs. In particular, many of the near-term reforms to current high-cost USF rules proposed in the NPRM, together with the potential direction of ICC reform, will cause the quality of broadband services in RLEC areas to fall significantly below the rest of the nation, jeopardizing further gains in rural broadband adoption, and require substantial rate increases for millions of rural consumers – potentially causing many to lose service entirely.<sup>3</sup>

To avoid these adverse consequences while still achieving the fundamental principles of reform identified in the NPRM, the Commission should consider alternative approaches to USF and ICC reform for RLECs as suggested in these comments. The roadmap offered herein, as initially outlined in an *ex parte* meeting to the Commission in January 2011<sup>4</sup> and further described in these comments (the “RLEC Plan” or “Plan”), is designed to be consistent with the Commission’s broadband reform principles *without* compromising the availability and

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<sup>2</sup> *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13 (rel. Feb. 9, 2011) (*NPRM*).

<sup>3</sup> Adverse impacts associated with the NPRM’s short-term reform proposals are summarized in Section III below and described in more detail in Appendix B.

<sup>4</sup> Letter from Joe Douglas, NECA, to Marlene H. Dortch, FCC, WC Docket No. 10-90 (filed Jan. 27, 2011).

affordability of *both* quality voice and reasonably comparable broadband services for customers throughout RLEC service areas.

Specifically, the RLEC Plan will:

- ***Modernize USF and ICC for Broadband:*** The RLEC Plan achieves the Commission’s goal of modernizing USF and ICC for broadband in a manner that is “*specific, predictable and sufficient*” as required under section 254 of the Communications Act of 1934, as amended (the “Act”), and will assure that advanced services and rates in rural areas are “reasonably comparable” to those available to consumers and businesses in urban areas. The RLEC Plan also establishes a clear and well-defined path for transitioning from today’s voice-oriented support mechanisms to one that explicitly supports broadband and IP-capable networks. Moreover, the RLEC Plan promotes responsible investment that will both *keep* high-cost areas “served” where broadband is currently deployed *and* permit the responsible edging-out of broadband into currently unserved high-cost areas.
- ***Achieve Fiscal Responsibility:*** The RLEC Plan serves the Commission’s aim for fiscal responsibility by permitting carriers to continue broadband deployment efforts in line with responsible engineering practices, while ensuring that those future deployment efforts are not artificially influenced by any incentives to “race to the top.” The RLEC Plan also addresses concerns with respect to efficiencies by extending a limitation on recovery of corporate operations expenses across all federal support mechanisms.
- ***Ensure Accountability:*** The Plan ensures accountability by carrying forward and recasting critical Carrier of Last Resort (“COLR”) responsibilities for a broadband environment, and the Commission should demand that *all* USF recipients live up to these responsibilities.
- ***Implement a Market-Driven Approach to USF and ICC Reform Policies:*** The RLEC Plan incorporates effective and efficient incentives for broadband deployment and adoption. The Plan also provides a clear and well-defined transition path for phasing out current federal high cost recovery mechanisms, and catalyzes the migration to a broadband-focused Connect America Fund (“CAF”). Moreover, the Plan is flexible -- since it has a well-defined and measured transition process with built-in “pause points,” it can be adjusted to reflect changes in the broadband marketplace. It will also promote responsible “edging out” of sustainable broadband in rural America, and is therefore complementary to broader efforts needed to deploy broadband in unserved areas throughout the country.

The RLEC Plan also responds to several other considerations described in the NPRM.

For example, it enables carriers to focus on broadband deployment and adoption *without* any “flash cuts” that would cause rural consumers and businesses to experience service disruptions,

declines in service quality, or drastic changes in rates for services. It recognizes the hybrid nature of today's federal-state USF and ICC mechanisms, and attempts to balance the clear need for both federal and state involvement in broadband deployment and high-cost support administration. Finally, by relying on in-place accounting, ratemaking and regulatory mechanisms, the Plan is designed to be implemented in a relatively rapid time frame, and is assured of being administratively workable for the long term.

In these comments, the Rural Associations provide an overview of the RLEC Plan, contrast the provisions of this Plan with the NPRM proposals, and explain how and why the RLEC Plan will better accomplish the Commission's ultimate USF and ICC reform goals. Although every effort has been made to "keep it simple," the Plan necessarily reflects the wide diversity of situations faced in providing broadband service in the highest-cost, most difficult to serve areas of our nation. The Rural Associations look forward to working with Commission staff and other stakeholders in the coming months to develop and implement the proposals described below.

The RLEC Plan has been developed to control growth in the Fund at a measured pace, with the expectation that, over at least the next decade or so, RLEC high-cost program support costs (adjusted for likely levels of inflation) would remain roughly the same as under existing rules. In offering these alternatives, however, the Rural Associations do not concur or concede that achievement of our nation's broadband deployment and adoption goals can be accomplished while keeping funding artificially and perpetually constrained to current levels. To the contrary, the Rural Associations continue to believe that concerns over Fund constraints have been allowed to override any realistic assessment of what will be required to expand and sustain high-quality, affordable broadband services throughout rural America. The Rural Associations also

have substantial concerns about the sources of cost recovery under any proposed reforms. If not very carefully constructed, reforms that eliminate or reduce ICC revenues without adequate restructuring or that shift broadband costs to the interstate jurisdiction without sufficient USF/CAF funding and meaningful incentives and a realistic opportunity for states to participate are doomed to fail – which would ultimately leave customers with unaffordable services, poor quality services, and/or no services at all.

The Rural Associations strongly suggest below that the Commission move forward expeditiously with consideration of ways to stabilize and broaden the USF contribution system in a way that will assure all Americans can access robust broadband services at affordable rates. On the assumption that the interest in constraining Fund growth will for the time being prevail over sizing the Fund “for the job ahead,” the Rural Associations suggest in these comments several sensible steps the Commission can take to control fund size, in a way that will permit continued maintenance and reasonable expansion of broadband in RLEC areas without harm to rural consumers. At the same time, if and when the Commission addresses contribution reform and decides to provide support levels built to ensure universal and affordable broadband, the RLEC Plan is flexible enough that it can be “recalibrated” to accommodate such a shift in priorities – indeed, the idea that the Commission should periodically and regularly re-evaluate program effectiveness, priorities, and next steps is a key component of the RLEC Plan.



## II. OVERVIEW OF REFORM STEPS UNDER THE RLEC PLAN.

### A. **Step One: The Commission Should Immediately Adopt *Near-Term* ICC Reform Measures, As Discussed in the Rural Associations' April 1, 2011 Comments.**

Consistent with the Rural Associations' comments on proposals set forth in Section XV of the NPRM,<sup>5</sup> the Commission, should as an immediate step toward modernizing the ICC rules, take the following actions:

- Promptly confirm that under existing law *all* traffic originating from or terminating to the public switched telephone network ("PSTN"), including but not limited to traffic associated with interconnected Voice over Internet Protocol ("VoIP") services and other provider network technologies, is subject to the existing applicable ICC obligations (including access charges, where applicable);
- Adopt rule revisions applying call signaling requirements, including mechanisms adequate to avoid fraud and ensure compliance with such requirements, to all forms of traffic originating or terminating on the PSTN and to all interconnected service providers, regardless of jurisdiction or technology;
- Adopt reasonable rules to address access rate development and allowed levels of earnings in access stimulation situations; and
- Make clear interconnecting carriers must pay applicable charges for traffic terminating on carrier networks.

As the Rural Associations explained in their April 1, 2011 comments, ongoing regulatory uncertainty surrounding the issues identified in Section XV of the NPRM has led to increasing numbers of billing disputes, complaints, litigation, and inefficient use of scarce resources among carriers and regulatory bodies, all of which could be better devoted to deploying, upgrading and operating broadband networks. By taking immediate action to address these issues, the Commission would stabilize the existing ICC system in the short term, reduce future pressure on

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<sup>5</sup> Comments of NECA, NTCA, OPASTCO, WTA, ERTA, The Rural Alliance, and The Rural Broadband Alliance, WC Docket No. 10-90 (filed Apr.1, 2011) (*Rural Associations' Section XV Comments*).

the USF, inject a degree of stability into the market that is presently lacking, and provide a springboard for longer-term reforms.

**B. Step Two: Effective January 1, 2012, the Commission Should Adopt Two Reasonable *Near-Term* Prospective Changes to the High-Cost USF Rules to Address Concerns Regarding Recovery of Capital and Operational Expenditures Through Today’s USF Mechanisms.**

Data indicate that RLECs have in fact operated efficiently and effectively by leveraging USF to deploy and sustain broadband-capable, multiple-use networks in some of the hardest-to-serve parts of the country with only minimal growth in the fund.<sup>6</sup> Nevertheless, the Commission has made clear its desire to address alleged inefficiencies in the cost recovery framework for RoR carriers.<sup>7</sup> The RLEC Plan addresses this objective by taking a targeted approach to constraining growth in high-cost support received by these carriers, who collectively serve 40 percent of the nation’s geography as COLRs. Specifically, as explained further in Section III, *infra*, the Commission should take the following actions in lieu of the near-term steps identified in the NPRM:

- 1. Impose a limitation on recovery of prospective RLEC capital expenditures based on analyses of booked study area costs to determine the portion of a carrier’s loop plant that has reached the end of its useful life and should be eligible for replacement.**

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<sup>6</sup> RLEC receipts from high-cost USF support have been increasing at only about 2.5 to 3 percent per year on average in recent years – even as RLEC receipts from ICC have declined over the same period and RLECs have edged out digital subscriber line (“DSL”)-speed broadband availability to over 92 percent of their customers, albeit at varying speeds. *See NECA Trends 2010- A report on rural telecom technology* (at 5) (available at [https://www.neca.org/cms400min/NECA\\_Templates/PublicInterior.aspx?id=100](https://www.neca.org/cms400min/NECA_Templates/PublicInterior.aspx?id=100)). Thus, even as the Rural Associations support the need for modernizing the Fund and reforming certain of its mechanics to address reasonable concerns such as the “race to the top” described above, the High-Cost program should be viewed overall as an effective and efficient tool for achieving broadband availability, not as a source of waste or inefficiency.

<sup>7</sup> *NPRM* ¶¶ 575, 597-599.

The Commission has pointed to the so-called “race to the top” as a source of potential inefficiency and has expressed concern about its perceived effect on the growth of the fund.<sup>8</sup> Specifically, the current mechanics of High-Cost Loop Support (“HCLS”) favor those with the highest-cost loops, thereby allowing carriers with the largest and most recent investments to qualify for more HCLS. To the extent any “race to the top” occurs, it undermines predictability and stability for current USF recipients. As other carriers invest to deploy and/or upgrade their own networks, a carrier that invested several years ago may find its HCLS receipts dwindling (and ultimately disappearing altogether), even though its costs have remained relatively constant (and high).

In light of how this affects their members, the Rural Associations support action to address this dynamic, but also urge the Commission to ensure that any resolution of this problem not generate greater instability than the problem itself. To achieve such a balance, the Rural Associations recommend the Commission adopt the prospective capital investment limitation described in detail in Appendix A to these comments.<sup>9</sup>

This constraint on network investment would tie the amount of an RLEC’s recovery of prospective investment that qualifies for high-cost support to the accumulated depreciation in its existing loop plant, which would serve as an estimate for the extent to which its existing facilities have reached the end of their economic life. This should minimize any actual or perceived incentive for carriers to invest in any manner that might be influenced in whole or part by a desire to obtain or retain HCLS. At the same time, this approach would provide a reasonable and tailored opportunity to recover costs of necessary plant upgrades and replacement where they are

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<sup>8</sup> *See id.* ¶ 179.

<sup>9</sup> Vantage Point, *Proposal for Allowed Loop Plant Capital Expenditures, For High Cost Funding of Future Loop Plant Investments*, April 2011.

needed based upon the conditions “on the ground” in that particular carrier’s serving area. Because each carrier’s USF “budget” for new capital investment in transmission plant would be tied to a percentage of its accumulated depreciation balance in any given year, as explained further in Appendix A, this “budget” would necessarily and appropriately reflect the particular circumstances and unique costs of operating in each specific rural area. Significantly, this forward-looking limitation would address the “race to the top” by tying both the magnitude and pace of most future investments to a schedule for replacement of depreciated plant over time, and thus would also help to manage any growth in the fund.

The proposed constraint would apply *only to future network investments* made after the new rules take effect. RLECs would continue to be able to recover the costs of existing investments, including committed investments such as stimulus fund projects arising from the American Recovery and Reinvestment Act (“ARRA”).<sup>10</sup> Applying this limitation on a forward-looking basis is appropriate given that, while it is reasonable to set clear and well-tailored ground rules to guide companies’ future investment decisions, it is unreasonable to apply any cost recovery limitations to prior investments made in good faith by carriers under current rules.<sup>11</sup>

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<sup>10</sup> American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 6001(k)(2)(D), 123 Stat. 115 (2009).

<sup>11</sup> Furthermore, as described further in Appendix A, this constraint would not apply to “Greenfield” deployments, because there is no depreciated plant to replace in such areas. Carriers would be permitted to request expedited waivers from the Commission and/or to obtain limited categorical exemptions from this constraint based on narrow predefined criteria. Finally, this constraint would need to be tied to carefully defined COLR mandates such as any speed and build-out requirements. The Commission must factor into any COLR requirements the impacts of any constraints on investment, so that the industry does not face unfunded mandates to deploy and operate where no funding is available to support such deployment or operation.

## **2. Cap recovery of corporate operations expenses by applying the current HCLS corporate operations expense cap formula to ICLS and LSS.**

Current rules governing the HCLS mechanism impose a cap on recovery of corporate operations expenses; rules governing the Interstate Common Line Support (“ICLS”) and Local Switching Support (“LSS”) mechanisms do not. The NPRM proposes to phase out recovery of corporate operations expenses from all three mechanisms, despite the fact that corporate operations activities are related and essential to the operation of networks and provision of sustainable, high-quality, and affordable services in rural areas.<sup>12</sup>

As a more reasonable alternative, the RLEC Plan proposes to apply the same corporate operations expense limitation currently imposed on HCLS payments to ICLS and LSS as well.<sup>13</sup> This expanded constraint strikes a reasonable balance between concerns regarding the perception that excessive corporate operations expenses are somehow recoverable via federal high-cost support mechanisms, while at the same time recognizing that the activities associated with such expenses are an integral part of providing universal service and should therefore be recoverable, to a reasonable degree, from federal support mechanisms.

## **3. These near-term steps will fully address the Commission’s primary reform objectives and establish effective conditions for longer-term reform.**

The two near-term reform proposals described above will constrain the extent to which RLECs may recover capital expenditures and operating expenses for their future investments and

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<sup>12</sup> Corporate operations expenses include costs associated with various accounting and finance functions, managing vendors, and regulatory compliance efforts, all of which are related to the provision of telecommunications services.

<sup>13</sup> As discussed *infra*, during the longer-term reform stage, this limitation would be applied across *all* federal support mechanisms – that is, as HCLS, ICLS, and LSS phase out during the transition, this cap would apply to these declining legacy mechanisms *as well as* the new CAF.

operations from federal high-cost mechanisms, in a far more reasonable and targeted manner than the near-term reforms proposed in the NPRM. (Specific insight into the impacts of the proposed near-term reforms is provided in Section III, *infra*. The Commission should also recognize that, under the longer-term RLEC proposals described below, existing mechanisms that support high-cost loop plant (including HCLS, ICLS and Safety Net Additive (“SNA”) support) will be phased out as support funding moves to a new RLEC CAF mechanism described below.<sup>14</sup> Together with the more reasonable and targeted limitations on capital expenditures and operational expenses proposed in the RLEC Plan, the planned phase-out of HCLS and ICLS obviates the need for the complicated and damaging interim changes to the existing RLEC high-cost support mechanisms proposed in the NPRM.

**C. Step Three: The Commission Should Begin *Longer-Term* Unification of ICC Rates in Cooperation with the States.**

The NPRM seeks comment on the path to long-term reform of the existing ICC regime. As an initial matter, the Rural Associations agree that reform of the current ICC rules is necessary to reflect today’s competitive marketplace as well as the gradual evolution to all-Internet Protocol (“IP”) networks. This reform must recognize that RLECs serving high-cost areas have made measured and prudent investments in broadband-capable and IP-based facilities in order to provide their customers with quality, modern services, both basic and advanced. They should be able to recover the costs of those investments without placing undue burdens on either their end-user customers or consumers nationwide through the USF.

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<sup>14</sup> As discussed in more detail below, *see infra* pp. 43-45, the future of LSS should be considered in conjunction with ICC reform, as LSS relates directly to switched access rate levels.

RLECs rely on ICC for a significant portion of their network cost recovery. Thus, it is essential that reform of the ICC system for these carriers include “measured transitions that enable stakeholders to adapt to changing circumstances and minimize disruptions.”<sup>15</sup> The RLEC Plan takes this approach and will achieve sustainable ICC reform, but without detriment to the networks, services, and rates that are available to the rural consumers in these areas.

**1. RLEC Intrastate and Interstate Switched Access Rates Should Be Unified at the Discretion of State Commissions, Using Incremental CAF Funding to Offset Resulting Revenue Reductions.**

Under the RLEC Plan for ICC reform, RLECs would, at the direction of their state commissions, lower their intrastate switched access rates (originating and terminating) to interstate rate levels.<sup>16</sup> This mirroring of RLECs’ intra- and interstate switched access rates and rate structures would have the immediate effect of reducing a significant source of the access rate arbitrage that has been occurring.<sup>17</sup>

It is critical, however, that any such ICC rate reductions are coupled with a sufficient restructure mechanism (“RM”) for RLECs. Interstate and intrastate access charges represent 29 percent of the typical RLEC’s revenues<sup>18</sup> which, along with universal service support and end-

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<sup>15</sup> *NPRM* ¶ 12.

<sup>16</sup> The RLEC Plan is consistent with another industry proposal cited in the *NPRM*, except that the intrastate rate reductions would not be mandated by the FCC, but instead would be made at the state commissions’ discretion and direction. *Id.* ¶ 555.

<sup>17</sup> *See id.* ¶ 552 (“There is general industry sentiment that intrastate rates should be reduced first because they are the highest, and because eliminating the discrepancy between intrastate and interstate access charges could reduce arbitrage, such as phantom traffic.”). *See also* Connecting America: The National Broadband Plan, FCC (rel. Mar. 16, 2010) at 142 (*NBP*); (“Rate differences lead to arbitrage opportunities such as phantom traffic, in which traffic is masked to avoid paying the terminating carrier intercarrier compensation entirely, and/or redirected to make it appear that the call should be subject to a lower rate.”).

<sup>18</sup> Comments of NECA, NTCA, *et al.*, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337 (filed July 12, 2010) at 37 (*Rural Associations’ July 2010 Comments*).

user rates, provide RLECs with cost recovery needed to serve as a COLR and enable the deployment and ongoing provision of both basic and advanced services. A failure to enable RLECs to recover their lost access revenues would severely impact their ability to transition to an all-IP network with ubiquitous broadband availability, as the National Broadband Plan (“NBP”) envisions. Moreover, absent a sufficient RM, the typical RLEC with limited financial resources will have trouble repaying outstanding loans, meeting current payrolls, fulfilling service responsibilities, and simply maintaining existing network plant.<sup>19</sup>

The Rural Associations propose the RM be calculated as the difference between each carrier’s intrastate switched access revenues and revenues obtained by charging access minutes at the interstate rate. Use of access revenues, as opposed to costs, is justified in view of the difficulty of obtaining reliable and consistent data on intrastate access revenue requirements, as states apply wide variety of approaches to regulation of intrastate rate levels and associated costs.<sup>20</sup>

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(Estimating state access revenues represent 12 percent of a typical RLEC’s income stream and interstate access revenues (switched and special) constitute 17 percent thereof).

<sup>19</sup> It is critical to note that any RM must be *incremental* to current levels of USF support. If the size of the fund cannot be expanded at all to accommodate access restructuring, this will necessarily mean that cost recovery will have to come entirely and directly from massive increases in end-user rates. *See infra* pp. 17-21. There is substantial precedent for this approach to access charge reform and the migration of implicit subsidies into explicit support. *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long-Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962 (2000) (*CALLS Order*); *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket Nos. 96-45, 98-77, 98-166, 00-256, Second Report and Order and Further Notice of Proposed Rulemaking Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613 (2001) (*MAG Order*).

<sup>20</sup> Comments of NECA, WC Docket No. 05-337 (filed Nov. 26, 2008) at 5.



The establishment of a federal RM to offset reductions in RLEC ICC receipts is entirely consistent with the purpose of universal service support and is necessary to achieve the objectives contained in section 254 of the Act. This is because infrastructure investment and current end-user rates in RLEC areas have been built on the foundation of current support flows and revenues. Therefore, it is unreasonable to expect that rural consumers will continue to have access to reasonably comparable services, including advanced services, at reasonably comparable rates, absent a sufficient RM.<sup>21</sup> Indeed, the inclusion of a RM in any reform plan must be seen as a critical component of ongoing performance of key COLR obligations (both as to quality voice *and* broadband) and, as with USF itself, the Rural Associations submit that only those who commit to serve as a COLR for such services *throughout* an applicable high-cost area should be eligible to receive any RM.

The NPRM seeks comment on whether all categories of ICC rates should be reduced at the outset.<sup>22</sup> The RLEC Plan contemplates that rates for other traffic (*i.e.*, interstate switched access and reciprocal compensation) would be examined in a further stage of this proceeding, in three to five years.<sup>23</sup> This will give the Commission and the industry time to examine subsequent market developments and weigh the effects of initial intrastate rate reductions. This also has the benefit of ensuring that the size of any RM is manageable and does not impose too

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<sup>21</sup> See *MAG Order* at 120-138. (The FCC created ICLS to replace implicit support in the interstate access rate structure of rate-of-return carriers.) “Consistent with the Act, this new support mechanism will help to ensure the availability of high quality telecommunications service at affordable and reasonably comparable rates after the CCL charge is phased out, and further our policy of promoting telecommunications investment in rural America.” *Id.* at 120.

<sup>22</sup> *NPRM* ¶ 553.

<sup>23</sup> This staged approach to ICC reform is consistent with the approach recommended in the past by other carriers. See Letter from CenturyLink, Consolidated Communications, Frontier Communications Corporation, Iowa Telecommunications Services, and Windstream Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 7, 2009) (*Broadband Now Plan*).

great a burden on the size of the USF/CAF.<sup>24</sup> Moreover, assuming that the Commission adopts appropriate rules to discourage carriers from engaging in access stimulation,<sup>25</sup> there is no need to begin lowering interstate rates during the initial stage of the transition merely to address this issue.<sup>26</sup>

The RLEC Plan also provides a strong incentive for state commissions to direct RLECs to lower their intrastate switched access rates, without the need for the FCC to take the legally-questionable step of mandating such action.<sup>27</sup> If a state commission directs or permits the RLECs in its state to reduce their intrastate switched access rates to interstate levels, in conjunction with a benchmark local voice service rate of \$25 per line per month,<sup>28</sup> RLECs in that state would be eligible to receive incremental federal RM funding from the CAF equal to the shortfall from mirroring interstate traffic sensitive switched access rates, plus any lost intrastate

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<sup>24</sup> *NPRM* ¶ 553. (stating that “reducing all rates concurrently may increase any recovery from the CAF needed early in the transition...”).

<sup>25</sup> *Rural Associations’ Section XV Comments* (filed Apr. 1, 2011) at 30-36.

<sup>26</sup> The *NPRM* expresses concern that “if interstate access rates remain unchanged during the initial stage of the transition, arbitrage such as access stimulation that is based on absolute rate levels (rather than on jurisdictional differences) would be more likely to continue.” *NPRM* ¶ 552. These issues can and should be addressed by the Commission as discussed in the *Rural Associations’ April 1, 2011 Comments* in this proceeding. *Rural Associations’ Section XV Comments* at 30.

<sup>27</sup> The *NPRM* appears to acknowledge that, at most, the Commission’s authority with respect to intrastate traffic is limited to establishing a methodology by which a *state commission* can set rates. *NPRM* ¶¶ 512-516; *see also* 47 U.S.C. § 252(d)(2). The Commission cannot mandate a specific rate for any intrastate traffic, nor can it prescribe a results-oriented “methodology” that effectively leads to a pre-determined rate – or even a zero rate as would apply under a “bill-and-keep” regime. *See Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000), *aff’d in part and rev’d in part, Verizon Comm’s, Inc. v. FCC*, 535 U.S. 467 (2002), and *vacated in part, Iowa Utils. Bd. v. FCC*, 301 F.3d 957 (8th Cir. 2002) (holding that the Commission’s role was limited to resolving “general methodological issues,” that “[s]etting specific prices goes beyond the [Commission’s] authority to design a pricing methodology,” and that such an approach would “intrude[] on the states’ right to set the actual rates.”

<sup>28</sup> The local service benchmark rate of \$25 includes a composite weighted average basic local service rate, federal and state Subscriber Line Charges (“SLCs”), and state USF.

Carrier Common Line (“CCL”) revenues.<sup>29</sup> In contrast, states not opting to take advantage of federal RM amounts to offset intrastate rate reductions would presumably need to implement comparable reductions through local rate increases and/or the creation of a state universal service fund.

This approach has a number of additional benefits. As the Commission recognizes, the inclusion of a local service rate benchmark recognizes that some “early adopter” states have already rebalanced rates.<sup>30</sup> In addition, a \$25 benchmark would reduce the initial size of the RLEC portion of the RM by more than 40 percent, from approximately \$367 million (if the RM were based solely on reducing intrastate access rates to interstate levels, without a benchmark) to \$215 million.<sup>31</sup> The RLEC Plan also proposes that the initial RM be calculated based on the effect of reducing intrastate switched access rates to interstate levels for a base year (e.g., 2009), then adjusted each year by the change in the interstate switched access revenue requirement. Because interstate switched access revenue requirements historically have been declining, the size of the RM would reasonably be expected to decline over time as well.

In proposing a reasonable benchmark, the Rural Associations acknowledge that it is appropriate for RLECs with below-average local rates to first look to their end users for a portion of the recovery of lost revenues. At the same time, if the benchmark is set too high, it runs the

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<sup>29</sup> If the state commission decides not to permit local rates to be raised, the difference could be charged or imputed in federal SLCs.

<sup>30</sup> *NPRM* ¶ 574.

<sup>31</sup> See Appendix B, *Analysis of Projected Financial Impacts Associated with Near-Term Changes to USF Mechanisms Proposed by the Federal Communications Commission*, Table 9 (Updated state-level disaggregation of ICC reform impacts). Appendix B, Table 8 also provides analyses of subscriber impacts of several ICC reform scenarios, including per-line effects associated with reducing intrastate access rates to interstate levels, reducing intrastate and interstate access rates to nationally-averaged reciprocal compensation rates, and the effects of eliminating both rates. The RM required to offset impacts associated with the latter two scenarios would be materially higher than the approach described above.

risk of making basic voice service unaffordable and/or not reasonably comparable with urban rates, contrary to the objectives of the Act.<sup>32</sup> Ultimately, the RLEC Plan, with a reasonable \$25 local voice service benchmark, balances the needs of RLEC customers with consumers across the nation and enables the establishment of a manageable RM within the USF/CAF.

The NPRM questions whether an adequate opportunity for recovery already exists given the variety of regulated and non-regulated services provided over multi-purpose networks, and if so, how would it evaluate whether a provider's revenues are sufficient so that it does not need any additional recovery.<sup>33</sup> As a threshold matter, the Rural Associations note that any decision by the Commission to take into consideration the extent to which RLECs or other regulated carriers earn revenues from non-regulated services would appear to represent a dramatic about-face in Commission regulatory policy, which has for more than forty years emphasized the importance of keeping regulated and non-regulated costs and revenues separate.<sup>34</sup> This principle has been one of the cornerstones of the Commission's regulatory policy, on which its Part 64 Joint Cost Rules and numerous orders dealing with activities as diverse as Yellow Pages advertising<sup>35</sup> to Video Dialtone Services<sup>36</sup> to wireline broadband Internet access services rest.<sup>37</sup>

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<sup>32</sup> As noted above, the RM would become an incremental component to the USF/CAF, and thus would be used to support deployment and operations as a COLR in some of the hardest-to-serve, high-cost areas in rural America.

<sup>33</sup> *NPRM* ¶ 568.

<sup>34</sup> The Supreme Court has stated the basic rule for the treatment of unregulated revenues and costs for federal ratemaking purposes as follows: "Ratemaking is, of course subject to the rule that the income and expense of unregulated and regulated activities should be segregated." *FPC v. United Gas Pipe Line Co.*, 386 U.S. 237, 243 (1967). See also *Michigan Bell Tel. Co. v. Engler*, 257 F.3d 587, 594 (6<sup>th</sup> Cir. 2001). That case held, *inter alia*, an ILEC cannot be "required to subsidize [its] regulated services with income from rates either deemed to be competitive, or with revenues generated from unregulated services."

<sup>35</sup> See *American Tel. & Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1 (1977).

<sup>36</sup> See *New England Telephone and Telegraph Co.*, Order and Authorization, 10 FCC Rcd 5346 (1995).

While the Commission is obviously free to change even long-standing regulatory policies in light of changes in circumstances,<sup>38</sup> a reviewing court would be bound to question why, after insisting for years carriers keep *costs* of non-regulated services out of regulated accounts, the Commission suddenly has developed an interest in counting non-regulated *revenues* as an offset to federal funding.

In any event, while the Rural Associations strongly oppose efforts by the Commission to count revenues from non-regulated sources in determining federal support amounts for broadband network provisioning, such revenues if considered at all would need to be evaluated on a net basis (i.e., after accounting fully for the *costs* of such activities).<sup>39</sup>

Finally, the Commission should not employ a results-oriented approach pursuant to sections 251 and 252 to unify all intercarrier rates, including those for intrastate calls, under the

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<sup>37</sup> *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers; Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services; Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review - Review of Computer III and ONA Safeguards and Requirements; Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 USC §160(c) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Services Provided Via Fiber to the Premises; and Consumer Protection in the Broadband Era, Report & Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ¶ 136.*

<sup>38</sup> *E.g., Southern Co. Services, Inc. v. FCC*, 313 F.3d 574 (D.C. Cir. 2002); *Greater Boston Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970).

<sup>39</sup> The NPRM seeks data to analyze existing revenues, assess the magnitude of revenue reductions resulting from the proposed reforms, and determine the appropriate size and scope of a recovery mechanism. *NPRM* ¶ 572. The Associations note in this regard NECA's April 6, 2011 submission of confidential pooling data, as well as additional information gathered on a voluntary basis from pool members relating to revenues from a variety of sources. The data available did not, however, in all cases identify the corresponding *expenses* that would need to be part and parcel of any expanded calculation that looks beyond regulated operations. *See* Letter from Regina McNeil, NECA, to Marlene H. Dortch, FCC, CC Docket No. 01-92, GN Docket No. 09-51, WC Docket Nos. 05-337, 07-135, 10-90 (filed Apr. 6, 2011) (redacted version).

framework of reciprocal compensation. The Commission appears to recognize that the legal foundation on which this approach rests is, at best, uncertain and would most likely face a robust legal challenge.<sup>40</sup> In light of its clear legal shortcomings,<sup>41</sup> such a unilateral, top-down federal mandate would only complicate and delay the Commission's efforts at long-term ICC reform, perpetuate the substantial uncertainty that already surrounds the ICC regime, and likely fail upon ultimate appeal. Moreover, as demonstrated above, such an approach is entirely unnecessary. The Commission should instead pursue reform as suggested by the RLEC Plan in cooperation with states (together with strong incentives for state participation) based on the existing jurisdictional framework.

**2. RLEC Switched Access Rates Should Be Unified On an Individual Company Basis; Neither A Uniform National Rate Nor A Uniform Transition Period Should Be Adopted.**

It is important to begin the process of rationalizing RLECs' access rates by first lowering switched intrastate access rates to interstate rate levels and rate structure for each individual carrier (at the discretion of state commissions). It is neither necessary nor appropriate, however, to establish an arbitrary uniform access rate that all carriers would charge. A uniform rate across all carriers would fail to account for the differences in costs incurred by carriers or the unique circumstances associated with providing service in high-cost rural areas of the nation.

RLEC interstate access rates are cost-based and thus, necessarily, and logically, higher than the rates of larger price cap carriers. Even among RLECs themselves, costs can vary

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<sup>40</sup> *NPRM* ¶ 537 (“By focusing on areas that the courts have made clear are within the Commission’s jurisdiction, this option [*i.e.*, reform based on the existing jurisdictional framework] could minimize the risk of litigation and disputes, providing greater stability regarding the reform.”).

<sup>41</sup> *See supra* note 27.

significantly and access rates differ based on those costs.<sup>42</sup> Were the Commission to adopt a uniform rate for all carriers, this would necessitate a steeper reduction of RLECs' existing rates than for other carriers, thereby eliminating a larger portion of their revenues. This larger upfront drop in rates would, in turn, place greater upward pressure on end-user local rates in rural areas and/or the RM, neither of which is desirable.

In its 2001 MAG access charge reform order for RoR ILECs, the Commission declined to prescribe a single target rate precisely because such rates were not supported by cost data. Instead, the Commission took an approach that accommodated the diversity among RoR carriers by "reallocating" costs and removing implicit support to create more efficient rate structures, while allowing carriers to establish rates based on their own costs.<sup>43</sup> This approach has worked well and remains based upon sound logic, and there is no need for the Commission to depart from it as it proceeds with ICC reform.

The NPRM also seeks comment on whether, considering that RoR carriers' interstate switched access rates are higher than those of price cap carriers, RoR carriers should be given a longer transition to whatever end-point for ICC reform is established.<sup>44</sup> As explained above, not only are RoR carriers' access rates higher than price cap carriers, they also represent a greater percentage of their revenues, meaning that these revenues are indispensable for loan repayments, maintenance of existing plant, and continued deployment and upgrades of broadband service. Thus, it is entirely appropriate that these carriers have additional time to absorb rate reductions in

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<sup>42</sup> RLECs that participate in NECA's traffic sensitive pool do not all charge the same rate. Instead, carriers are placed into "rate bands" and the carriers in each band charge different rates to reflect differences in costs. As the Commission proceeds with ICC reform, it is important that pooling, along with rate banding, be permitted to continue.

<sup>43</sup> *MAG Order*, 16 FCC Rcd 19613 (2001) ¶ 83.

<sup>44</sup> *NPRM* ¶ 542.

a manner that does not disrupt their ability to serve consumers residing in their service areas. Moreover, utilizing clearly defined “pause points” within the reform process will help the Commission to calibrate its reform efforts, ensuring that further rate reductions match developments in the market and regulatory requirements.

### **3. The Commission Should Not Pursue A Mandatory Bill-And-Keep Methodology or Any Other Artificial and Arbitrary Low Rate As The End-Point For Comprehensive ICC Reform.**

The NPRM seeks comment on different ICC methodologies the Commission might adopt as an end-point for comprehensive reform, when networks are entirely IP-based.<sup>45</sup> One of the options being explored is a bill-and-keep methodology.<sup>46</sup> A mandatory bill-and-keep regime (or any other regime that sets rates at some amount lower than reasonable cost) would impose substantial additional burdens upon RLEC customers and should therefore be rejected for these carriers.<sup>47</sup>

As the NPRM recognizes, under a bill-and-keep methodology carriers would not charge other service providers for the costs of originating, transporting, or terminating their traffic. Instead, they would recover such costs from their own end users, possibly in conjunction with CAF support.<sup>48</sup> As discussed above, because of the typically high-cost areas that they serve, RLEC ICC rates are higher than those charged by larger, urban-based carriers, and those charges compose a larger percentage of their revenues. If RLECs were no longer permitted to charge

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<sup>45</sup> *Id.* ¶¶ 529-532.

<sup>46</sup> *Id.* ¶ 530.

<sup>47</sup> Likewise, the Rural Associations also strongly oppose the mandatory use of near-zero rates, such as \$0.0007, proposed in prior proceedings. For many carriers the costs of merely billing and collecting a \$0.0007 or similar rate are higher than the rate itself, making it even worse than a bill-and-keep methodology.

<sup>48</sup> *NPRM* ¶ 530.



other carriers for the use of their networks, an RLEC's limited end-user customer base would likely need to be relied upon to recover the overwhelming majority of these costs. This would cause end-user rates to skyrocket to unaffordable levels, and lead customers to discontinue service, contrary to the objectives of section 254 and the Commission's own priorities for the federal High-Cost program in this proceeding.<sup>49</sup> In turn, RLECs would have neither the ability nor incentive to continue investing in their networks, and further broadband deployment and upgrades would come to a halt.

Of course, in theory, the adverse consumer impacts of a bill-and-keep mechanism (or other regime that imposes some artificially low rate) could be averted by explicit universal service support in the form of a very large CAF, which would necessarily be larger than would otherwise be the case if some type of intercarrier payments continued to exist in an all-IP environment.<sup>50</sup> However, this would appear to be at odds with the Commission's stated intent to contain the growth in the USF and to "limit the contribution burden on households."<sup>51</sup> Continuing to allow RLECs to bill other carriers for use of the network in some manner will therefore serve both the interests of rural consumers living in RLEC service areas as well as consumers nationwide.

Beyond the universal service implications of a mandatory bill-and-keep (or other artificially low rate) methodology for RLECs, it is important to recognize that long distance toll carriers and other service providers, along with their end users, benefit from the utilization of

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<sup>49</sup> *Id.* ¶ 80 (stating that "[t]hird, the program must ensure that rates for broadband service are reasonably comparable in all regions of the nation, and rates for voice service are reasonably comparable in all regions of the nation. Availability of broadband and voice service by itself is not a sufficient goal. We must also make sure that rates are reasonably comparable so that consumers have meaningful access to these services.") (emphasis in the original).

<sup>50</sup> See Appendix B, Table 8.

<sup>51</sup> *NPRM* ¶ 9.

expensive RLEC networks to originate, transport, and terminate calls. The prescription of a mandatory bill-and-keep regime or an arbitrarily-selected, below-cost rate would prohibit a reasonable allocation of costs to these other carriers that reflects a rational measure of their use of RLEC networks. This creates the potential for arbitrage opportunities.

For instance, a compensation rate of zero for the use of a network with non-zero cost characteristics sends improper pricing signals to interexchange carriers (“IXCs”), wireless carriers, VoIP providers and others that could lead to uneconomic increases in the usage of the network. That, in turn, would require increased capacity in RLEC networks to accommodate the surge in traffic over nominally “free” facilities.<sup>52</sup> However, with no revenue provided by these other carriers for their network usage, RLECs would lack funding to make needed plant upgrades<sup>53</sup> unless they significantly increased rates for rural end users. Rather than impose all or most of RLEC network costs on rural end users, requiring payment for network usage from all network users, including other carriers, promotes economic efficiency, as network demand will be based on the cost of using the network.<sup>54</sup>

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<sup>52</sup> It is also important to ensure that sensible ICC reform is not undermined by changes in interconnection or transport obligations that result in rates and rules being shifted simultaneously in ways that counteract or defeat one another – *e.g.*, the rates may be appropriately “re-set” for the ways in which networks interconnect now, but they end up resulting in either excessively high costs or “free” facilities when applied within a different interconnection or transport regime. *NPRM* ¶¶ 678-683. The Commission would be better served by addressing rate level matters first and evaluating how those reforms progress before trying to rework the existing interconnection and transport regimes as well. In this regard the three to five year “pause point” discussed elsewhere herein would serve particularly well for considering revisions to the underlying interconnection and transport framework.

<sup>53</sup> Another arbitrage opportunity created by a bill-and-keep regime is that customers that generate large amounts of originating long distance traffic will substitute the special access services that they currently purchase with free switched access. Also, an organization may create its own IXC to avoid local service charges, thus arbitraging local and switched access service.

<sup>54</sup> The *NPRM* (at ¶¶ 506, 527) suggests the current ICC regime incents RLECs and other carriers to maintain and invest in legacy, circuit-switched networks simply to collect higher ICC revenues, and thus hinders transformation of networks to IP architecture. For RLECs, these

Moreover, it is questionable at best as to whether the Commission has the legal authority to adopt a mandatory bill-and-keep regime or to prescribe a specific rate for intrastate traffic. Even if the Commission were to move forward with ICC reform using a section 251 reciprocal compensation framework (which the Rural Associations oppose), section 252(d)(2)(A) of the Act states that the terms and conditions for a reciprocal compensation arrangement are not considered just and reasonable unless: (a) it provides for the mutual and reciprocal recovery of each carrier's transport and termination costs, and (b) those costs are based on a reasonable approximation of the "additional costs" of termination.<sup>55</sup> While there are various economic theories on how "additional costs" should be calculated, it is highly unlikely that a rate of zero would meet the "additional cost" standard whenever the traffic between two carriers is significantly out of balance.<sup>56</sup> Furthermore, while section 252(d)(2)(B)(i) of the Act forbids the prohibition of *mutually agreed upon* (i.e., voluntary) bill-and-keep arrangements,<sup>57</sup> section 252(d)(2)(B)(ii) explicitly prohibits the Commission from using its section 252(d) authority to

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assertions are baseless. RLECs have made great strides in replacing older time-division multiplexing ("TDM")-based switching equipment with new IP "softswitches" and increasingly offer IP interconnection. Approximately 19 percent of host switches in NECA's TS pool have been replaced by softswitches. See NECA Tariff F.C.C. No. 5, Access Service, Trans. No. 1257 (filed Nov. 13, 2009) (effective Dec. 28, 2009). (NECA IP Gateway filing). The RLEC Plan, as discussed below, also contemplates potential replacement of today's minutes-based ICC mechanisms with alternative structures designed for IP interconnection, such as "port and link" charges. See *infra* note 74. Moreover, while per-minute ICC revenues account for a significant percentage of RLEC cost recovery, it is far from their only revenue source. RLECs, on average, recover just as large a portion of their regulated revenues from their end users as they do from access charges. Most RLECs also have strong incentives to operate efficiently (to maintain competitive rates) and to offer modern IP-based broadband services to meet customer demands.

<sup>55</sup> 47 U.S.C. § 252(d)(2)(A).

<sup>56</sup> Comments of NECA, WC Docket No. 05-337 (filed Nov. 26, 2008) at 26-29.

<sup>57</sup> 47 U.S.C. § 252(d)(2)(B)(i).

“engage in any rate regulation proceeding to establish with particularity the additional costs of transporting or terminating calls,”<sup>58</sup> which would necessarily include a cost of zero.

It is possible that when networks become entirely IP-based, an ICC regime consisting primarily of per-minute charges may no longer be appropriate or even desirable. That does not mean, however, that a mandatory bill-and-keep methodology is the logical end-point for comprehensive reform, or that usage will have no place in determining the applicable level of compensation. A service provider’s use of an all-IP network will still impose costs. Those costs of usage may just be incurred in a different manner than they are incurred on a circuit-switched network, and network operators should continue to have the ability to charge other service providers some form of just and reasonable, cost-based rates for the use of those networks.<sup>59</sup> Moreover, while the Commission (and the industry) may desire to move to an “end game” that is premised upon an all-IP network, the regulatory regime cannot pretend as if the “here and now” – with many customers still choosing affirmatively to purchase local services and/or wireless services that ride atop and depend upon the PSTN – does not exist at all. Rather, it is appropriate to put into place reforms that encourage migration towards the desired result, taking into account present circumstances.

What is most important is that the costs of *all* networks – IP, PSTN, or the hybrids that are likely to persist for some time – should be borne by all that benefit from their use, including other carriers, so that rural subscribers can continue to receive access to services and rates that are “reasonably comparable” to those offered in urban areas. For this reason, the RLEC Plan recommends taking ICC reform in sensible, well-defined stages, with “pause points” along the

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<sup>58</sup> *Id.* at § 252(d)(2)(B)(ii).

<sup>59</sup> *See, e.g., NPRM* ¶ 531 (suggesting that flat-rated interconnection charges may be appropriate to provide compensation for use of networks).

way to allow the Commission and the industry to take stock of market developments, technological advances, and regulatory needs that will help to inform how further reforms should be structured and implemented.

**D. Step Four: The Commission Should Implement an Evolved RLEC-Specific CAF Mechanism as Part of *Longer-Term* USF Reform.**

Consistent with one of the long-term reform options outlined in the NPRM,<sup>60</sup> the RLEC Plan contemplates development of a cost-based, “evolved RoR” funding mechanism specifically for RLECs that operates as a separate but complementary component of the overall CAF.

A separate RLEC-specific CAF mechanism is justified, as RLECs uniquely serve as COLRs in areas collectively covering 40 percent of the nation’s land mass but inhabited by only four percent of the population. These carriers typically provide service *throughout* areas where little, if any, business case exists for investing in telecommunications facilities absent “specific, predictable and sufficient” mechanisms that provide ongoing support.

In proposing an RLEC-specific CAF mechanism, the Rural Associations do not seek to minimize the importance of developing mechanisms to promote the availability of broadband services in rural areas not served by RLECs. To the contrary, the Rural Associations specifically affirm the need to develop long-term CAF mechanisms that set appropriately-tailored incentives and adequate requirements for investment and accountability on the part of price cap ILECs and other COLRs, and nothing in the RLEC Plan would interfere with or inhibit such initiatives. In fact, the RLEC plan has been designed to complement such efforts by demanding efficiency, accountability, and fiscal responsibility in the use of program funds. However, the solution to perceived problems with a “rural/rural digital divide” is not to undermine one set of rural

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<sup>60</sup> *Id.* ¶¶ 448-456.

customers in favor of others or put at risk the effective and efficient steps that RLECs have taken to date to deploy and provide affordable DSL-speed broadband services to consumers and businesses.

Reforming existing RLEC USF and ICC mechanisms to support broadband services presents other complex issues for the Commission and the telecommunications industry. Any plan must continue to satisfy the Act's objective of "reasonably comparable" services and rates in rural areas, as well as the Act's requirements for "specific, predictable and sufficient" support. The Commission also rightly seeks to assure efficiency and accountability in the use of funds, and has a strong and understandable interest in keeping the overall fund size reasonable.

The RLEC Plan addresses these issues in a way that allows for a smooth transition from today's mechanisms to tomorrow's framework, while ensuring that carriers who have made investments in network plant under current rules have a reasonable opportunity to recover those costs and well-defined guidance as to their ability to recover the costs of future investment. The RLEC Plan is also designed to constrain growth in the USF/CAF, while still providing the support reasonably necessary to "edge out" broadband to unserved areas and/or to enable upgrades in existing areas where broadband is available only at very low speeds or with limited service quality. The following section describes how these elements are brought together in a cohesive whole.

### **1. Start with Today's Interstate Costs.**

Under current rules, RLECs account for costs using a system of accounting, separations and cost allocation procedures designed to identify recoverable interstate and intrastate costs (*i.e.*, "revenue requirements"). These costs are then recovered via state and interstate end-user charges, access charges, and various state and federal support mechanisms.

The RLEC plan starts with current regulated interstate costs, including common line, traffic sensitive switched access and traffic sensitive special access, computed under the Commission’s existing Part 32, 36, 64 and 69 rules, subject to the constraints on recovery of costs from federal USF mechanisms discussed above.<sup>61</sup> That is, to promote accountability and regulatory visibility into where support is being directed, RLECs would continue to keep books of account in accordance with the Commission’s Part 32 rules, and would continue to comply with Part 36 and 64 rules regarding the separation of such costs between the state and interstate jurisdictions and between regulated and non-regulated accounts. Pending further reform of the Part 69 access charge rules, interstate revenue requirements would continue to be allocated between traffic sensitive and non-traffic sensitive rate categories for recovery via tariffed end-user and access charges.<sup>62</sup>

## **2. Add Support for “Middle Mile” Facilities and Access to the Internet Backbone.**

As the NBP and many commenters have recognized, a key roadblock to providing high-speed broadband Internet access services in rural areas, in addition to the cost of “last mile” and

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<sup>61</sup> *See supra* p. 9.

<sup>62</sup> The Rural Associations have previously explained that support based on actual costs determined under the Commission’s existing accounting rules makes them highly accountable to the public. RLEC data is subject to multiple layers of review from internal and external auditors, NECA, and potential audits by state commissions, USAC, and the Commission itself. In many cases, investments and other substantial expenditures must be approved by RUS or commercial lenders (*e.g.*, RTFC and CoBank) as well, before funds are committed. In short, theoretical claims of “inefficiencies” caused by basing support on actual costs are not consistent with the real-world operating environment facing RLECs. *Rural Associations’ July 2010 Comments* at 63.

“second mile” network facilities, is the cost of “middle mile” facilities and services between rural areas and the Internet backbone.<sup>63</sup>

Middle mile facilities represent a crucial link in the provisioning of broadband services. Even the most robust last-mile broadband network can be undermined by inadequate or unaffordable middle mile facilities. Moreover, a rural broadband network can be hampered by its own success. As more customers adopt broadband, this necessarily places a greater strain on middle mile facilities, potentially slowing down service for all and thus requiring increased middle mile capacity.

The RLEC Plan addresses this issue by adding a new, separate “middle mile” cost recovery component. Specifically, on an optional basis, those RLECs who elect to treat their middle mile costs as part of their regulated rate base, and thus tariff a distinct regulated middle mile transport service offering as a telecommunications service, would be entitled to recover the costs associated with middle mile transport. To ensure efficiency and fiscal responsibility, however, support from the CAF for the middle mile cost component would be constrained by measures based on capacity per subscriber (in Mbps) determined to be necessary under standard engineering practices to meet actual broadband demands of customers, and would reflect the actual cost per megabit of the in-place middle mile network. Relevant costs for recovery would

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<sup>63</sup> *See, e.g.*, Comments of NECA on NBP Public Notice #11, GN Docket No. 09-47 (filed Nov. 4, 2009); Comments of WTA, GN Docket No. 09-47 (filed Nov. 4, 2009); Comments of Verizon and Verizon Wireless on Impact of Middle and Second Mile Access on Broadband Availability and Deployment, GN Docket No. 09-47 (filed Nov. 4, 2009). *See also*, Comments of NECA, GN Docket No. 09-51 (filed June 8, 2009) at 13-14; Initial Comments of NTCA, GN Docket No. 09-51 (filed June 8, 2009) at 22.



include all “middle mile” broadband transmission facilities beyond the DSL Access Service Connection Point<sup>64</sup> as well as Internet backbone connection costs.<sup>65</sup>

### **3. Recognize Increasing Broadband Adoption Levels and Interstate Usage of the Network.**

The Commission has determined broadband Internet access service to be interstate in nature<sup>66</sup> and there are few, if any, who doubt consumers will increasingly adopt such services over time. It is nearly certain that use of “the network” will one day be substantially, if not exclusively, attributable to interstate broadband services. Still, a substantial number of customers today have yet to adopt broadband and continue to use only “plain old telephone service” (“POTS”) for a combination of intrastate and interstate services. A sensible, market-based transition path is clearly needed to reflect the historic jurisdictional shifts associated with consumers’ increasing adoption of broadband.

The RLEC Plan seeks to account for this shift by proposing discrete changes to today’s Part 36 separations rules, which currently allocate a fixed 25 percent of “last mile” Cable and Wire Facilities Category 1.3 and Central Office Equipment (“COE”) Category 4.13 “common line” loop costs to the interstate jurisdiction. Current rules also allocate 100 percent of Cable and

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<sup>64</sup> *I.e.*, the interconnection point designated by an RLEC at which the customer may interconnect to offer Internet access services. *See, e.g.*, NECA Tariff No. 5, Section 8.1.1.

<sup>65</sup> *See generally* Comments of NECA on NBP Public Notice #19, GN Docket No. 09-47 (filed Dec. 7, 2009) at 13 (describing broadband transmission cost components).

<sup>66</sup> *GTE Telephone Operating Cos.*, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466 (1998) (found GTE’s ADSL Internet access service to be an interstate service). *See also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) ¶ 52 (subsequent history omitted); *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185, *Internet Over Cable Declaratory Ruling Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, CS Docket No. 02-52, *Declaratory Ruling and Notice of Proposed Rulemaking*, 17 FCC Rcd 4798 (2002) ¶ 59 (subsequent history omitted).

Wire Facilities Category 1.2 loop costs associated with “naked DSL” services to the interstate jurisdiction.<sup>67</sup> The RLEC Plan calls for the Commission (in cooperation with a Federal-State Joint Board convened under section 410(c) of the Act) to revise its separations rules so as to allocate additional “last-mile” Category 1.3 and COE 4.13 loop costs to the interstate jurisdiction for individual RLECs based on their broadband adoption rates (i.e., the ratio of each RLEC’s customers who adopt broadband services to those who only utilize quality voice services).<sup>68</sup> These additional loops costs would be transitioned to interstate over a defined period of time to mitigate the impact on support levels, especially in instances where study areas have significantly high take rates.

Allocation of increasing percentages of common line loop costs to the interstate jurisdiction based on carriers’ broadband adoption rates has important implications for the Commission’s broadband goals. First, it will create substantial incentives for RLECs to encourage broadband adoption among customers. Second, this approach will drive the phase-out of existing high-cost support mechanisms as customers adopt broadband. In the case of HCLS, for example, increasing allocation of loop costs to interstate will allow smaller and smaller proportions of loop costs to be subject to the interstate expense adjustment mechanism described in Part 36 of the rules, which forms the basis for current HCLS payments.<sup>69</sup> Moreover, assigning

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<sup>67</sup> See 47 C.F.R. §§ 36.154-157.

<sup>68</sup> Additional last-mile Category 1.3 and COE 4.13 loop costs would be transitioned over time to phase-in amounts recovered through support for broadband transmission costs, consistent with increases in study area adoption rates.

<sup>69</sup> Under the RLEC Plan, if the amount of additional costs assigned to interstate by a carrier as a result of the additional interstate loop allocation is less than the HCLS calculated under existing rules, the difference between these two amounts would continue to be recovered from a (reduced) HCLS mechanism (“Grandfathered HCLS”). Once additional loop plant costs assigned to the interstate jurisdiction as a result of a carrier’s additional interstate loop allocation exceed the Grandfathered HCLS amount, however, no Grandfathered HCLS would be paid to that carrier. This transitional approach to “grandfathering” and ultimately phasing out of HCLS

increasing amounts of interstate loop costs to the RLEC-specific CAF mechanism based on broadband adoption rates will allow ICLS to transition lower, as it will provide support for customers who subscribe to stand-alone voice services and ultimately phases out altogether once customers cease purchasing stand-alone voice service.

#### **4. Compute Broadband Support Amount Under CAF.**

Based on costs determined using steps one through three above, an RLEC's CAF support would be calculated first by computing its Broadband Network Transmission Costs, incorporating last mile,<sup>70</sup> second mile, middle mile, and Internet connection costs associated with providing broadband services (*i.e.*, facilities actually used to provide DSL or just “naked” DSL service to end users).

From the Broadband Network Transmission Cost determined above, the RLEC CAF mechanism would subtract an urban wholesale benchmark (the “Benchmark”) designed to represent the costs of providing reasonably comparable wholesale broadband transmission services in urban areas.<sup>71</sup> Subtracting the product of an urban benchmark and working

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helps mitigate the potential for significant cost shifts to the intrastate jurisdiction and resulting substantial adverse impacts on intrastate customer rates. In no event, however, would the interstate allocation go below 25 percent even if the broadband adoption rate is less than 25 percent.

<sup>70</sup> The “last mile” component of the Broadband Network Transmission Cost would include current common line loop costs assigned to the interstate jurisdiction based on the existing 25 percent allocation factor, multiplied by the carrier's broadband adoption rate, plus the additional loop cost assigned to interstate based on the carrier's broadband adoption rate, along with 100 percent of “naked” DSL loop costs.

<sup>71</sup> This wholesale urban benchmark can be determined in a variety of ways (*e.g.*, based on surveys of prices for urban Internet access services, such as Form 477 process) and should be evaluated and potentially adjusted each year to maintain urban comparability, including the effects of offering increasingly higher (and varying) speeds in urban areas over time. In addition, urban retail rates should be discounted by a factor to remove the estimated portion of the rate attributable to non-regulated retail-level costs. This approach avoids the need to determine urban carriers' actual non-regulated costs in calculating the wholesale benchmark, and

broadband lines (DSL and “naked” DSL) from rural Broadband Network Transmission costs assures that CAF support is directed to high-cost areas and will allow rates for end users in such areas to be reasonably comparable to rates paid by urban customers for comparable broadband services. Under this calculation, broadband-based CAF support amounts would increase – and legacy support mechanisms such as HCLS and ICLS will decrease – as broadband adoption increases.

The RLEC Plan contemplates retaining a transitional ICLS component to RLEC support amounts calculated under this formula, to assure continuation of reasonably affordable service to customers obtaining *only* local exchange voice services.<sup>72</sup> As noted above, when customers shift from voice-only services to broadband, loop costs under the RLEC Plan are supported by the CAF calculation, and thus this transitional ICLS will decline over time as broadband adoption accelerates. Loop costs attributable to voice-only services remain in the common line revenue requirement, however, and ICLS will continue to be calculated by subtracting revenues from SLCs assessed to voice-only customers from this reduced level of common line costs. Transitional ICLS will phase out as more customers subscribe to broadband, and ICLS recovery will be eliminated altogether once an RLEC is fully transitioned to broadband-based network services (including provision of quality voice services over broadband connections).<sup>73</sup>

To be clear, however, the increasing allocation of loop costs to the interstate jurisdiction and the associated Benchmark described in this section hang upon a very delicate balance. If the

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also avoids any need for the Commission to determine the reasonability of retail rates associated with Title I services.

<sup>72</sup> An RLEC’s transitional ICLS is calculated by multiplying the current interstate loop costs, assigned to interstate based on the existing 25 percent allocation, by the reciprocal of the broadband adoption rate (*i.e.*, one minus the adoption rate).

<sup>73</sup> *See supra* note 69.

Commission is unwilling or unable to provide sufficient support for the recovery of investment in existing networks and to enable the responsible “edging out” of broadband over time, or if the Benchmark is “misused” in a manner that unreasonably increases the costs that must be recovered from end users without tether to “reasonable comparability,” the Commission runs the substantial risk that carriers will be unable to: (1) continue delivering quality, affordable broadband where they do so today; (2) upgrade broadband where needed to respond to consumer demand; and/or (3) edge out broadband on a responsible but reasonably quick basis into those areas where broadband service is unavailable today. Put simply, if a carefully designed balance is not maintained in any implemented reform, customers will almost certainly see “rate shock” as support disappears, and some operators who offer service where little, if any, business case exists for doing so will fail.

If the Commission is going to be assuming increased regulatory responsibility to promote the deployment and cost recovery of broadband-capable networks (since broadband services are interstate in nature), it is therefore essential that the Commission consider the impact of any shifts in cost recovery on the affordability of end user rates, the incentives of states to create and maintain their own universal service funds, the availability and sustainability of broadband-capable networks in high-cost rural areas, and the sustainability of the USF/CAF itself. In a realm with a significant number of “moving dials,” the Commission cannot overlook the possibility that reform will result in substantial amounts needing to be recovered from end users who are unable to pay the higher rates necessary to cover the costs. If this occurs, the result will be diminished service quality and/or the outright failure of providers who committed decades ago to serve these consumers that were neglected by larger providers looking for better business cases. Thus, the mechanics of reform hang upon a very delicate balance, and there is substantial

risk that in tinkering with any one component of reform, the entire framework ceases to function properly and creates substantially adverse unintended consequences for consumers.

### **5. Recovering Remaining Interstate Costs.**

Subtracting RLEC CAF support amounts (including transitional ICLS) from interstate revenue requirements, as determined above, as well as LSS or its CAF replacement as determined in the Commission’s ICC reform proceeding, will yield residual interstate cost amounts for recovery via a combination of end-user and other customer charges. In addition to the recovery of costs from broadband services as reflected in the Benchmark described in the immediately preceding subsection these charges would initially include today’s federal SLCs, switched access charges (to the extent these charges continue to apply under ICC reform) and special access charges, including charges for wholesale broadband services. As the broadband marketplace and services evolve, however, these rate structures are expected to evolve as well.<sup>74</sup>

#### **E. Step Five: Monitor and Periodically Recalibrate These Reformed ICC and USF Mechanisms as Needed.**

The Rural Associations estimate that the increase in total disbursements under the combined RLEC USF/CAF mechanisms (excluding RM amounts associated with ICC reform) will be comparable to (if not less than) outlays under existing high cost mechanisms, which have been growing at a modest 2.5 to 3 percent annual rate as broadband services are extended to rural consumers. That is, after adjusting for likely inflation, overall RLEC High-Cost program costs should remain approximately the same as current disbursement levels. In return, the

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<sup>74</sup> In an IP-connected environment, for example, minute-based charges mandated under current FCC Part 69 rules could be replaced by capacity and IP-based transport measures (*e.g.*, “port and link” rate structures). The RLEC Plan can easily accommodate recovery of residual revenue requirements from end users and wholesale sources (*i.e.*, other carriers and service providers) under either approach.

Commission and the public can expect accountability in the form of maintenance of existing broadband infrastructure and affordable rates in RLEC areas. In addition, effective, efficient and responsible progress can be expected in terms of deployment, upgrades, and adoption levels, as RLECs “edge out” to presently-unserved areas and improve service over time in areas covered by existing infrastructure.<sup>75</sup>

Cost and deployment estimates are, of course, subject to change based on a variety of factors. As just one example, the Commission has been considering comprehensive ICC reform for over a decade – yet the idea that ICC reform might promote broadband deployment earned nothing more than a passing reference in the April 2001 notice initiating this effort.<sup>76</sup> It is clear that even the best predictive judgments as to where a market will be in 10 years, or what reforms might be necessary to reach that “end game,” are almost certain to miss the mark. Indeed, the only guarantee may be that technology and market developments will, over 10 years, outpace and/or render moot any reforms that the Commission and the industry put into place today.

Thus, to take a more measured and prudent approach to reform, as discussed above in connection with long-term ICC reform measures, the Rural Associations recommend the Commission plan an additional proceeding approximately three to five years following initial implementation of the RLEC CAF mechanism. The purpose of this proceeding would be to examine both program cost trends and the gains made with respect to deployment and adoption. At that time, the Commission can make a rational assessment of the need for further modifications to the RLEC Plan.

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<sup>75</sup> While RLECs have 92 percent broadband availability at varying speeds, much needs to be done to maintain those networks and also to achieve deployment of broadband networks capable of meeting customer broadband service demands going forward, particularly as speeds may be expected to increase significantly every few years.

<sup>76</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) at ¶ 33.

In so doing, however, the Commission should be mindful of the impacts of regulatory uncertainty on investments. Recent filings by the Rural Associations and other parties have highlighted the detrimental impacts of such uncertainty on RLEC investment decisions following publication of the Commission's NBP.<sup>77</sup> The Commission should accordingly make clear in promulgating new High-Cost rules for RLECs that those rules, while subject to reasonable and narrowly designed mid-course "re-calibrations," will establish a stable base for cost recovery going forward, over a significant time period (e.g., at least 10 years). Otherwise, investors will continue to sit on the sidelines and rural Americans will fall behind in their ability to access robust and affordable advanced broadband services.

### **III. THE RLEC PLAN FULLY ADDRESSES THE COMMISSION'S NEAR-TERM REFORM GOALS IN THIS PROCEEDING WITHOUT HARMING RURAL CONSUMERS.**

#### **A. The Commission Should Adopt the Near-Term Measures Recommended in the RLEC Plan Rather than the Near-Term Proposals in the NPRM to Revise Current RLEC High-Cost Distribution Rules.**

The near-term reforms to the current RLEC high-cost support rules proposed in the NPRM will have dramatic adverse impacts on RLECs and the consumers they serve. Several individual companies and consulting organizations have already presented the Commission with

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<sup>77</sup> E.g., Comments of NECA, NTCA, *et al.*, GN Docket No. 11-16 (filed Mar. 2, 2011) at 4; Joint Reply of NECA, NTCA, *et al.*, WC Docket Nos. 10-90 and 05-337, GN Docket No. 09-51 (filed Aug. 11, 2010) at 4-5; Comments filed by Blooston Rural Carriers at 19, North Dakota Rural Telephone Group (ND Telcos) at 8, Farmers Telecommunications Cooperative at 7, JSI at 12, Fiber-To-The-Home Council at 2, Home Telephone at 7, Border Companies at 12, Pioneer Communications at 6 (all filed on July 12, 2010, in WC Docket No. 10-90); Letter from Sarah Tyree, CoBank, to Marlene H. Dortch, FCC, GN Docket No. 09-51 (filed Dec. 16, 2009).



detailed analyses showing the extent to which the NPRM's proposals will serve to increase consumer rates and/or force existing companies to discontinue service in high-cost areas.<sup>78</sup>

In Appendix B to these comments, the Rural Associations provide their own analyses of how the NPRM's near-term proposals to revise current RLEC High-Cost disbursement rules would affect rural consumers nationwide. These analyses also show that the proposed revisions will have substantial adverse impacts on rural consumers and the small, community-based carriers these consumers depend upon for quality voice and broadband services. The Rural Associations' findings can be summarized as follows:

**1. Proposed Changes in HCLS Reimbursement Rates Would Disrupt Current Operations.**

The Commission proposes to change current HCLS reimbursement percentages for incumbent LECs operating 200,000 or fewer loops to 55 percent and 65 percent, respectively.<sup>79</sup> The NPRM explains, “[a] reduction in the reimbursement percentages, even a modest reduction as proposed, may encourage incumbent LECs to invest and expend funds more efficiently and effectively, without jeopardizing universal service.”<sup>80</sup>

As discussed above, RLECs welcome, more than anyone, the Commission's attention to the “race to the top” dilemma that occurs as a result of the cap imposed on HCLS, and propose reasonable steps to address this concern. But even within policy changes that are intended to be merely “redistributive” in nature, those policies should be forward-looking and must not

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<sup>78</sup> *E.g.*, Letter from Cammie Hughes, Texas Statewide Telephone Cooperative, Inc., to Marlene H. Dortch, FCC, WC Docket No. 10-90 (filed Mar. 29, 2011); Letter from Douglas K. Kitch, Alexicon, to Marlene H. Dortch, FCC WC Docket No. 10-90 (filed Mar. 31, 2011); Letter from Tom Karalis, Fred Williamson & Associates, to Marlene H. Dortch, FCC, WC Docket No. 10-90 (filed Mar. 23, 2011).

<sup>79</sup> *NPRM* ¶ 180.

<sup>80</sup> *Id.*

“reshuffle” support in a way that puts at risk *prior* investment made under existing rules and runs the substantial risk of upsetting the quality or affordability of services provided to consumers and businesses.

Changing support percentages in this manner on an overall basis may have minimal overall impact on funding but will cause significant non-uniform and quite disruptive shifts in support between companies under the cap. If the reimbursement formulas are changed as proposed in the NPRM, 115 study areas that currently are not eligible to receive support would qualify to receive support, because of the lower loop cost threshold required to satisfy the cap. Moreover, while the top ten percent of companies would receive additional support of \$1.56 per line per month, the bottom ten percent would need to raise local service rates by about \$7.63 per month from this revision.

In comparison, the future investment constraint proposed above by the Rural Associations offers a far less disruptive, more reasonably tailored, and forward-looking means of addressing the incentives to “race to the top” created by the current mechanics of HCLS.

## **2. Eliminating Recovery of Corporate Operating Expenses Through High-Cost Support Would Undermine Customer Service and Adversely Affect Consumer and Carrier Rates.**

As noted above, proposals to eliminate recovery of corporate operations expenses completely from USF reimbursement mechanisms assume, erroneously, that these expenses are unrelated to the provision of universal service in high-cost areas. In fact, corporate operations activities are related and essential to the provision of sustainable, high-quality, and affordable services in rural areas.<sup>81</sup>

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<sup>81</sup> See *supra* p. 11.

The elimination of corporate operations expense recovery from USF support, by itself, would cause RLECs to experience revenue losses of about 4.5 percent on average. But again, as shown in Appendix B, the ten percent of companies most negatively affected by this change will experience revenue losses of fourteen percent or higher. This translates into local rate increases of \$27.35 per line per month *or more* for companies in that group. These results cannot be squared with section 254's requirement for "reasonable comparability" between urban and rural rates and services.

Appendix B also provides an analysis of the impact of the combined potential effects of changing USF reimbursement ratios and eliminating corporate operations expense recovery. Here, adverse impacts are significantly worse, with companies experiencing on average a 5.2 percent drop in revenue, with those in the top ten percent group experiencing revenue losses of 15 percent or more (translating to potential local rate increases of \$33.61 per line per month).

Appendix B also provides information on the impact such changes could have on company Times Interest Earned Ratio ("TIER") calculations, used by key lenders such as the Rural Utilities Service ("RUS") to determine whether to loan funds to RLECs.<sup>82</sup> Generally speaking, companies with TIER numbers less than one are ineligible for loans. If the Commission were to revise HCLS percentages and eliminate recovery of corporate operations expenses from federal USF mechanisms, the percentage of companies analyzed in Appendix B that would fall below the TIER cut-off (based on analysis of regulated account data) would increase from 25.3 percent currently to 47.1 percent.

If the Commission believes further restrictions on recovery of corporate operations expenses are needed, it should at most apply the existing HCLS corporate operations expense

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<sup>82</sup> See also *Rural Associations' July 2010 Comments* at 43.

cap to ICLS and LSS, as discussed above. This approach offers a more reasonable way to discourage inefficiencies and address recovery of such expenses, without posing substantial risk to legitimate cost recovery and potential rate shock for consumers.

**3. More Reasonable Alternatives Exist to the Proposed Elimination of Safety Net Additive Support.**

Appendix B to these comments also analyzes the impact of phasing out SNA support, as proposed in the NPRM.<sup>83</sup> In this case, RLECs receiving such support would lose an average of \$3.34 per line per month if SNA were eliminated. Losses by RLECs range from \$.01 per line per month to as much as \$14.33 per line per month.

From discussion in the NPRM, it appears the Commission's primary concern with SNA support relates to the impact of line losses on support levels. That is, qualification for SNA support is currently determined by measuring growth in year-end telecommunications plant-in-service ("TPIS") investment on a *per-line* basis.<sup>84</sup> While intended to provide additional support to companies making significant investments in plant, SNA may also inadvertently be provided to companies that experience significant line losses from year-to-year without making additional investments. A more reasonable way to address this problem would be to modify the SNA qualification test so that it is based on increases in *total* investment rather than the current percentage increase in TPIS investment per loop. This would preserve support for companies most in need of SNA and mitigate harms associated with complete elimination of SNA support.<sup>85</sup>

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<sup>83</sup> NPRM ¶ 175.

<sup>84</sup> *Id.* ¶¶ 183-184.

<sup>85</sup> Appendix B at 4.

However, *any* change to SNA rules should apply only to future investment, excluding any committed investment projects and ARRA stimulus fund projects.<sup>86</sup>

**4. The Commission Should Not Eliminate LSS or Combine It With HCLS – Adjustments to LSS Should Come as Part of ICC Reform.**

As further shown in Appendix B, eliminating LSS would have a dramatic impact on interstate access rates, causing local switching rates to increase by 127 percent, with an overall increase in traffic sensitive switched access charges of about 80 percent -- a result directly contrary to the Commission's ICC reform goals. This occurs because the proposal to eliminate recovery of LSS does not affect the allocation of additional switching costs under the Commission's Part 36 Dial Equipment Minute ("DEM") weighting rules, which forms the basis for LSS payments. Thus, if these costs cannot be recovered from LSS, DEM weighting amounts would simply be re-added to RLECs' interstate local switching revenue requirements, for recovery via switched access rates, substantially increasing existing arbitrage pressures.<sup>87</sup>

On the other hand, if the Commission were to seek to revise the Part 36 separations rules so as to reallocate local switching costs to the state jurisdiction by eliminating the DEM weighting factor (a process requiring input from a federal-state joint board convened under section 410(c) of the Act), the impact of eliminating LSS would add approximately \$4.37 per line per month on average to end user local service bills. For companies most affected by this change, monthly rates would increase by \$16.91 per line per month or more.<sup>88</sup>

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<sup>86</sup> Under existing rules, SNA support is only available in a qualifying year and in four subsequent years. *NPRM* ¶ 182. See 47 C.F.R. § 36.605(c)(3)(ii). Thus, current rules automatically reduce and eliminate SNA for recipient companies over time.

<sup>87</sup> This, of course, is precisely contrary to Commission goals for ICC reform. *NPRM* ¶¶ 603-607 (Section XV); See also *Rural Associations' Section XV Comments* (filed Apr. 1, 2011) at 13-18.

<sup>88</sup> Appendix B also includes an analysis of the effects of combining LSS with HCLS, as proposed in the *NPRM*. In this case, while overall impacts are revenue neutral, ten percent of

The Commission bases its proposal to eliminate LSS on the finding that “telecommunications technology has been evolving from circuit-switched to an IP-based environment and many smaller RoR carriers are purchasing soft switches.”<sup>89</sup> As a threshold matter, the deployment of soft switches in some areas does not mean it is practical or desirable to replace all existing circuit switches. Whereas it makes no sense for RLECs to invest in and deploy new circuit switches, some existing circuit switches still perform useful functions and do not need to be replaced precipitously. Moreover, even a soft switch for a small carrier often involves an initial capital expenditure of \$400,000 - \$600,000 - a significant amount for any size carrier that should not be made until necessary, particularly by the smallest carriers for whom LSS was primarily intended. Indeed, even in an “all-IP” world, softswitches and routers perform intelligent functions to direct packets from point of origination to point of destination, and even if the costs of these devices were less than those for circuit switches, it cannot be argued that these devices and functions are costless, nor should it be concluded that those who cause such costs should obtain use of them for free.

The NPRM’s alternative proposal of combining LSS with HCLS would also have unintended adverse consequences. Under current rules, rural ILECs whose loop plant costs exceed 115 percent of the national average cost per loop (“NACPL”) potentially qualify to receive HCLS.<sup>90</sup> On the other hand, LSS provides support for switching costs, by allowing ILECs with 50,000 lines or fewer to shift a greater portion of those costs to the interstate

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RLECs would have to increase local rates by at least \$6.47 per month or more, while the ten percent of RLECs at the opposite end of the spectrum could reduce rates by about \$4.43 or more per month.

<sup>89</sup> *NPRM* ¶ 187.

<sup>90</sup> In reality, the cap on HCLS makes the qualifying threshold much higher than 115 percent of the NACPL.

jurisdiction. The dual mechanisms enable support to be distributed in a focused manner: a carrier with more than 50,000 lines, but whose loop costs exceed 115 percent of the NACPL, can potentially obtain HCLS, while a smaller carrier with fewer than 50,000 lines can obtain cost recovery for its switches even if its loop costs are below the qualifying threshold for HCLS.<sup>91</sup>

The Rural Associations nevertheless recognize that the economics governing switch deployment and cost recovery in RLEC areas has changed since the DEM weighting rules (and LSS mechanism) were first implemented. The most appropriate solution would be to address the future of LSS in conjunction with the Commission's ICC reform proceeding, which contemplates reducing (not materially increasing) switched access rates. For example, LSS could be moved into CAF funding in conjunction with replacement funding used to bring intrastate rates to interstate rate levels. Or, it could continue to transition lower as a result of continued reductions in switched access cost levels, and be addressed at a later date as the Commission considers the need for further ICC reform in three to five years as discussed above. As part of such proceedings, the Commission could also consider specifying accelerated depreciation schedules for TDM-based switching plant, which would have the effect of reducing revenue requirements for local switching plant on a faster basis and speed the phase-out of LSS as well, while assuring small companies a reasonable opportunity to recover costs associated with such investments.

**5. A Cap on Total, Annual Per-Line High-Cost USF Support Should Not Be Imposed on RLECs Without Considering Individual Circumstances.**

Appendix B demonstrates the Commission's proposal to impose a \$3,000 annual limit on total per-line high-cost support would have severe impacts on a small number of subscribers with

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<sup>91</sup> *NPRM ¶¶ 186-188.*

very little impact on the fund or savings in contribution rates. For example, if such a cap is imposed only on non-tribal companies located in the contiguous 48 states, as the NPRM appears to suggest, about 12,000 customers would experience rate increases ranging from \$9.24 per line per month to the obviously unsustainable level of \$1,200 per line per month. Yet, the effect of imposing such a cap would be to reduce overall high-cost disbursements by less than \$15 million per year, an amount that would in turn reduce the USF contribution factor by only about 0.025 percent.<sup>92</sup>

The NPRM acknowledges that only a small number of companies would be affected by this proposal,<sup>93</sup> but in emphasizing high per-line support amounts the Commission fails to recognize each affected company provides service to a relatively small number of customers, with the result that the overall impact on universal service funding is small. Thus, while it appears reasonable to ask, as the NPRM does, “whether requiring American consumers and small businesses, whose contributions support universal service, to pay more than \$3,000 annually or more than \$250 per month for a single home phone line is consistent with fiscally responsible universal service reform,”<sup>94</sup> the question is incomplete. The Commission also needs to consider as well the fact that support provided to these companies makes up a relatively small percentage of total support, and as such adds a vanishingly small amount to the overall contribution factor.<sup>95</sup>

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<sup>92</sup> Based on 2<sup>nd</sup> Quarter 2011 revenue base and using the current contributions calculation methodology.

<sup>93</sup> *NPRM* ¶ 209.

<sup>94</sup> *Id.* ¶ 210.

<sup>95</sup> Based on annualized second quarter 2011 support amounts, the impact of capping support for these companies represents less than 1% (0.72%) of the rural RoR carriers’ 2011 support.



While it is certainly reasonable to ask whether it makes sense, as a policy matter, for USF mechanisms to support higher per-line levels going forward, the Commission must consider the consequences of imposing such a limit on existing customers and the companies who have made substantial investments under existing rules to provide COLR services to them. The Rural Associations suggest that, rather than abandon the provision of wireline service to current customers, the Commission set reasonable parameters for supporting extremely high-cost consumers in advance and, at most, consider imposing per-line limits on existing services only after affording affected companies and their subscribers an opportunity to justify their support needs on the bases of their particular facts and circumstances.

**B. Mandatory Disaggregation of RLECs' Support Will Not Serve – and Will in Fact Undermine – the Commission's Reform Objectives.**

The Commission also proposes as part of its near-term USF reform proposals to require rural carriers to disaggregate support within existing study areas, beginning in 2012.<sup>96</sup> Even as it does so, however, the Commission acknowledges that “disaggregation of support would not alter the total amount of support that an incumbent LEC would receive in a given study area.”<sup>97</sup> Instead, the Commission introduces the concept of disaggregation as a step toward identifying on a more granular basis those areas in need of ongoing support in the future.<sup>98</sup>

The Commission first provided for geographic disaggregation of study area-averaged support in 2001, as an option to help ensure that competitive eligible telecommunications carriers (“CETCs”) would receive a lower per-line support amount under the “identical support rule” if

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<sup>96</sup> *NPRM* ¶ 375.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

they served only the lower-cost portions of a study area.<sup>99</sup> But, with the proposal in the NPRM to eliminate the identical support rule and phase out such payments to CETCs over several years,<sup>100</sup> there is little, if any, reason to undertake the arduous process of disaggregating study area-averaged support now.

Even today, USAC describes the disaggregation process as having required “a *large-scale* effort . . . to review and extract zone information and pricing data from ILEC disaggregation plans.”<sup>101</sup> Moreover, as the Commission notes, “[f]ew incumbent carriers took advantage of these disaggregation options.”<sup>102</sup> Given that a “large-scale effort” was required to achieve disaggregation for only a “few” carriers who availed themselves of this process, one can only imagine the magnitude of the effort that would be required to disaggregate the study areas of rural ILECs across the country. Only the consultants and legal advisors specializing in such efforts would seem poised to benefit from this task.<sup>103</sup>

These additional administrative costs would come with little apparent (or, certainly, immediate) benefit. It is essential the Commission identify clear and meaningful objectives for such a massive undertaking before setting off down such a path. The Rural Associations understand that the Commission’s high-level hope is to inject CAF support into areas where it is most needed, but widespread disaggregation is unnecessary to achieve this purpose. It would be

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<sup>99</sup> *MAG Order*, 16 FCC Rcd at 19613 (2001) ¶ 144.

<sup>100</sup> *NPRM* ¶ 247.

<sup>101</sup> See USAC, *Understanding Disaggregation* (available at <http://www.usac.org/hc/about/understanding-disaggregation.aspx>) (emphasis added).

<sup>102</sup> *NPRM* ¶ 378.

<sup>103</sup> Of course, if the Commission eliminates the potential for recovery of any corporate operations expenses from universal service support as proposed (*see id.* ¶¶ 194-200), it is unclear how and whether RLECs attempting to deploy and sustain broadband-based investments in high-cost areas would also be in position to bear the substantial administrative costs associated with this new comprehensive disaggregation mandate.

far more efficient as a matter of sequence first to identify unserved areas (or other areas that somehow require “targeted support”) and then, only if found necessary at that time, *consider* disaggregation of the affected study areas (or other measures) to achieve the appropriate level of targeted funding.

This is clearly preferable to a rule compelling every rural ILEC across the country to undertake significant support disaggregation exercises that could turn out to be irrelevant in the vast majority of instances, particularly when the Commission itself has acknowledged that disaggregation pursuant to the *Rural Task Force* procedures would have no impact on the total amount of support received. It would be far more prudent to undertake disaggregation only if and when there is a clear purpose and application for it in a given study area.

The same reasoning applies with equal, if not greater, force to the notion that states should be encouraged to start redrawing existing study area boundaries now in anticipation of subsequent USF/CAF reforms.<sup>104</sup> Burdening the states and the industry with such efforts before the Commission has arrived at a final design for the CAF and identified the specific benefits that would be derived from the redrawing of study areas is both unfair and unnecessary.

As a first step, the Commission should instead establish clearly how the CAF will operate in its “future-state” following the Phase I transition, including the geographic scope for which support would be provided in any given area. This is certainly a more logical and orderly approach than requiring states and industry to guess at where the CAF might be headed and redraw study area boundaries in anticipation of such a “moving target.”

Furthermore, as the Commission rightly notes, “by determining the need for support in smaller areas, total support levels in some areas may increase because there would be little or no

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<sup>104</sup> *Id.* ¶ 384.

cross-subsidy from lower cost areas within the carrier’s service area.”<sup>105</sup> Recalculating where support is needed without the benefit of averaging is likely to result in many, if not all, cases where an increase in the level of support is needed to serve customers in high-cost areas. This is a substantial concern at a time when the Commission has expressed great interest in *constraining* growth of the USF.

Indeed, this same concern about the prospect of carriers eliminating averaging and subdividing their own study areas to maximize USF support is what initially drove the Joint Board on Universal Service and the Commission to propose and adopt a study area boundary freeze, and to condition waivers of that freeze upon a showing that the specific boundary modification would not place pressure on the USF.<sup>106</sup> To the extent the Commission now requires all rural ILECs to disaggregate their support and eliminates the benefits of cost averaging within high-cost study areas, it runs the risk of ballooning the size of the fund.

**C. The Commission Should Proceed With Great Caution in Considering Any Proposal to Reduce or Eliminate USF Support in So-Called “Competitive” Areas.**

The NPRM also asks whether and how the Commission should address so-called “competitive” areas, where a second provider interconnecting with an ILEC pursuant to a voluntary agreement under section 252 of the Act operates without high-cost support.<sup>107</sup> This is

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<sup>105</sup> *Id.* ¶ 388.

<sup>106</sup> *See, e.g., MTS and WATS Market Structure*, CC Docket No. 78-72, and *Amendment of Part 67 of the Commission’s Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Recommended Decision and Order, 48 Fed. Reg. 48325, 48337 (1984).

<sup>107</sup> To be clear, the discussion in this subsection applies only to situations where there is existing competitive entry by a entity providing telephone service (and other required services) in an RLEC study area subject to a state-approved interconnection agreement, not to situations where an RLEC has, or will in the future, seek to exercise its rights to a fact-based inquiry by a state commission pursuant to the “rural exemption” as provided in section 251(f)(1) of the Act. *See, e.g., CRC Communications of Maine, Inc., Investigation Pursuant to 47 U.S.C. sec. 251(f)(1)*

the so-called “donut and hole” concept, under which a supported carrier might lose or receive reduced support associated with the delivery of services in the competitive “hole” because an unsupported provider is able to operate there.<sup>108</sup>

Presumably, if this concept were adopted and a competitor were operating without support or cross-subsidy of any kind – *i.e.*, if the area is truly “economic” to serve when evaluated on a stand-alone basis – the Commission would proceed to disaggregate the relevant ILEC’s study area and allocate costs in some manner between the “hole” in which the competitor exists and the “donut” that continues to be served solely by the ILEC without a competitive presence. But given the substantial likelihood that the competitor will operate in the most densely populated (*i.e.*, lowest-cost) portion of any given study area, any disaggregation and re-allocation of costs will almost certainly result in an *increase* in support for the ILEC, as the benefits of averaging associated with the lower-cost “hole” are eliminated and the higher costs of serving the “donut” must be taken fully into account on a stand-alone basis.<sup>109</sup>

Here again, at a time when the Commission is seeking to constrain growth in the fund *and* find greater efficiencies in the use of high-cost support dollars, any process that proposes to “target” support to non-competitive portions of study areas is likely to produce precisely the opposite effects – the pressures on the fund will *increase* and the efficiencies that come today from averaging of costs over an entire study area will be all but *eliminated*.

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Regarding CRC Communications of Maine Request of UniTel, Inc., *et al.* Docket Nos. 2009-40-44, Order (Maine PUC July 9, 2010), (Maine Commission found undue economic burden on the RLECs would occur with competitive entry into portions of RLEC study areas, and such entry was not consistent with, and would be harmful to, universal service obligations pursuant to section 254.)

<sup>108</sup> *NPRM* ¶ 391.

<sup>109</sup> *See id.* ¶ 388.

Thus, while “targeting” support to “more granular areas” may sound preferable in concept, it threatens to undermine the Commission’s core reform objectives, increase pressures on the fund, and hamstring the efficient distribution of support funds to those places that truly do need them most.

Finally, to the extent the Commission remains determined to move forward with implementation of a “donut and hole” concept notwithstanding the substantial issues and concerns flagged above, there is a need to define quite carefully the process and implications of any finding that a competitive “hole” exists, and also to address a number of significant complications and inequitable results that will likely arise from such a process.

First, any “trigger” for a finding of competition (and thus the existence of a “hole”) must be well-defined. Rather than creating a “rebuttable presumption that universal service support is unnecessary” where a threshold percentage of customers can receive service from an unsubsidized competitor,<sup>110</sup> the process should be triggered by the petition of an unsubsidized competitor making certain showings. Specifically, the competitor should be required to aver and show through clear and convincing evidence that, at a minimum: (a) it is a state-certified carrier or eligible telecommunications carrier (“ETC”) (to ensure some minimum level of service quality); (b) it can deliver, as of the date of the filing of the petition, both broadband (as defined by the Commission for support) *and* quality voice services to at least 95 percent of the households in the specific area through use of its own facilities (or in combination with the resale of another carrier’s services) and in a manner comparable to the relevant USF/CAF recipient (*i.e.*, fixed or mobile service, as applicable);<sup>111</sup> (c) it offers each of those broadband and voice

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<sup>110</sup> *Id.* ¶ 391.

<sup>111</sup> The Commission should divide fixed and mobile services since they are complementary in nature. For example, a fixed wireless provider who can otherwise meet all the criteria could

services on a stand-alone basis at rates that are reasonably comparable to those offered by the ILEC (to ensure affordability of rates for consumers);<sup>112</sup> and (d) it neither receives high-cost support of any kind *nor* cross-subsidizes its operations in the specific, affected census block.<sup>113</sup>

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petition with respect to an area in which a fixed wireline provider receives USF/CAF support, but could not disqualify a mobile provider from receiving support. *See also* National Cable & Telecommunications Association, Reducing Universal Service Support in Geographic Areas that are Experiencing Unsupported Facilities-Based Competition, Petition for Rulemaking, GN Docket No. 09-51 and WC Docket No. 05-337 (filed Nov. 5, 2009) at 13-14 (recognizing that including wireless providers in the competitive nature of an area “would add complexity” and noting that the Commission has yet to make a finding that wireless voice service is a complete substitute for wireline voice service); Martin Scott, *Operators Should Position Mobile Broadband as a Complement to Fixed, Not a Substitute*, Analysis Mason, Feb. 22, 2011 (available at: <http://www.analysismason.com/About-Us/News/Newsletter/Operators-should-position-mobile-broadband-as-a-complement-to-fixed-not-a-substitute/?journey=1391>.) (“Attempts to sell mobile broadband as a substitute to fixed are likely to fail as there is a strong perception among consumers that mobile broadband is not as fast, more unreliable and more pricey than fixed broadband.”) *See infra* pp. 75-77.

<sup>112</sup> Use of the National Broadband Map produced by the National Telecommunications and Information Agency (“NTIA”) is of significant concern and little value in this regard. First, the map does not show the extent to which the competitor offers voice service. Second, even as to the availability of broadband services, the map only shows availability *within* a census block or road segment, and does not indicate the specific percentage of households actually able to take service in those areas. Third, there are such substantial questions about the accuracy of the map – at least in its initial iteration – such that using it to evaluate competition and potentially withdraw some or all of an RLEC’s support could be construed as arbitrary and capricious. *E.g.*, Gerald S. Ford, PhD, *Challenges in Using the National Broadband Map’s Data*, Phoenix Center Policy Bulletin No. 27, Mar. 2011. The Commission and the public interest would therefore be far better served by requiring the competitor to present clear and convincing evidence of the extent of its specific deployment over a particular census block or grouping of census blocks rather than trying to differentiate between “donuts” and “holes” based upon the National Broadband Map.

<sup>113</sup> This analysis is essential if the Commission is determined to proceed forward with the imposition of a “donut and hole” analysis, notwithstanding all of the concerns and complications discussed above. If the Commission’s interest truly is to identify areas in which support is not needed to maintain service, it must take into account not only explicit support that might be received by a provider for operations in that area, but also the possibility that the competitive provider is cross-subsidizing its operations in an otherwise “uneconomic” area with operations in more densely populated and profitable areas. Any competitor seeking to establish that a competitive “hole” exists and thereby reduce or eliminate high-cost support for another provider therefore must be required to present evidence (in the form of *pro forma* financial statements for its operations in that area) demonstrating that the area is indeed “economic” of its own accord and can support a *stand-alone* business plan (i.e., that service in the area is not being cross-

The ILEC or other high-cost support recipient should also be provided with a reasonable and meaningful opportunity to evaluate the claims made in any such petition, and to present evidence refuting any of the facts averred therein.

Second, if the Commission proceeds to implement a “donut and hole” concept, it must define with precision the consequences of a competitive “hole” existing within a given study area. Specifically, the Commission must establish whether the high-cost support recipient will lose all support in the “hole” or only a portion of that support. If it will lose *all* support in the “hole,” then the ILEC or other support recipient must be permitted to disaggregate its costs and recalibrate its support for the other areas it serves as described in the preceding pages of this section – even though that may likely lead to an *increased* need for high-cost support as described above.<sup>114</sup>

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subsidized by revenues/profits from the CATV operator’s other service areas). Absent such a showing, the Commission runs the risk of failing to identify accurately those areas that are in fact “uneconomic” to serve, thereby reducing or eliminating support where it is needed based upon the actual characteristics of those areas such as density, addressable market, etc. It should also be noted that, to the extent that the Commission takes non-regulated revenues into account in determining what level of high-cost support an RLEC should receive – an approach opposed by the Rural Associations as it conflates regulated and non-regulated operations and would appear to not take into account non-regulated expenses that may far outweigh non-regulated revenues – the Commission should then also take into account the extent to which any competitor realizes a “benefit” from lower, non-regulated expenses. For example, to the extent that multiple-system cable providers benefit from lower programming costs that lead to greater margins on video service offerings this represents a potential “cross-subsidy” in terms of operations in that area that must be accounted for if both regulated and non-regulated operations are taken into account. This discussion highlights once again, of course, the complications and potential pitfalls of a regulator mixing its analysis with respect to regulated “apples” and non-regulated “oranges.”

<sup>114</sup> Indeed, so that carriers are not unfairly denied cost recovery, an additional complication that the Commission needs to consider and resolve is the possibility that disaggregation will result in a carrier’s annual per-line cost recovery exceeding a defined cap, such as the \$3,000 cap proposed in the NPRM. *See NPRM ¶¶* 208-215. It is quite possible that a carrier would be well below the cap based upon its total study area-averaged costs, only to see its per-line support increase significantly following the disaggregation of costs.



Moreover, if the ILEC or other support recipient will lose *all* support in the “hole,” it should be entitled to a complete release from any and all regulatory obligations associated with serving as an incumbent and COLR in the “hole”<sup>115</sup> In effect, the ILEC or other support recipient should then be deemed in all respects to be a competitive LEC for purposes of operations in that “hole.” Of course, the Commission would need to consider the complications arising from such a result. If, for example, the carrier that is no longer receiving support in the “hole” is excused from COLR obligations, it would appear to put the Commission in the position of effectively having to preempt a state’s COLR designation, and it is unclear what authority exists for the Commission to do so.

Alternatively, the Commission might provide the ILEC or other support recipient the option to retain a reduced level of support associated with operations in the “hole” in recognition of continuing COLR obligations. Such a reduction should place a value on the continued service as a COLR by the support recipient and provide some level of funding to sustain those obligations. This approach would help ensure the maintenance of service quality within the “hole,” could provide insurance against market exit (or retrenchment) by the competitor, may allow the Commission to sidestep concerns about how to preempt states that wish to continue to enforce COLR obligations in the “hole,” and could presumably reduce the strain on support needs in “donut” areas depending upon whether the reduction in support was calculated via disaggregation or some other means.

It is essential, however, that the Commission define with precision what level of continuing support would be provided. A carrier being tasked with continuing operation as a COLR cannot be expected to comply with unfunded mandates to deliver service in a high-cost

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<sup>115</sup> *See id.* ¶ 391.

“hole” and meet its COLR obligations where it receives inadequate support to serve every customer in that area. It would also be necessary to recalculate and likely increase support for “donut” areas served by the COLR, as discussed above.

Finally, if it is determined to proceed forward with a “donut and hole” approach, the Commission must ensure that any reductions or eliminations of support do not affect the ability of RLECs to recover existing investments made under current rules. Any cut-off or reduction of funding used to recover the cost of existing investment in a “hole” would violate the core statutory principles that require that USF funding be predictable and sufficient. RLECs have efficiently invested in their networks under the current rules and pursuant to their COLR obligations to make quality voice service ubiquitously available throughout their territories *and* to offer broadband services to as many of their customers as possible.<sup>116</sup> A COLR that invested in what is subsequently considered a competitive “hole” and that is dependent on support to recover such good faith investments must not be punished for rules and limitations developed only after the fact. Thus, if it proceeds to apply a “competitive area” approach notwithstanding all of these substantial complications and concerns that still require resolution, the Commission should ensure that any reductions or eliminations of support apply only to investments and associated operating expenses made or incurred on a prospective basis.

**D. Other Near-Term Reforms Proposed in the NPRM, Including Elimination of the Identical Support Rule for CETCs, Streamlining the Study Area Waiver Process, and Elimination of the “Parent Trap” Rule, Have Merit and Should Be Acted Upon.**

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<sup>116</sup> As the Commission noted in the NPRM, high-cost USF support received by RoR carriers increased by only 3 percent per year on average between 2006 and 2010. *Id.* at 59, Figure 7. Over the same period, RLECs increased their collective broadband availability (at varying speed capabilities) using USF support to leverage their private investment in mixed-use plant – from 81 percent in 2008 to 92 percent in 2010. NECA Trends, *supra* note 6.

The Rural Associations have long supported elimination of the current identical support rule.<sup>117</sup> The services and service qualities furnished by ILECs and CETCs to rural areas, as well as the costs incurred to provide them, are not identical.<sup>118</sup> Different network technologies provide different service functionalities and entail different construction, operating and maintenance costs. In addition, the Commission has recognized that the identical support rule has led to an inefficient use of funds, as it has incited CETCs to maximize their “line” counts in the lower-cost portions of RLECs’ study areas, rather than build-out their networks to serve high-cost customers.<sup>119</sup> Further, as incumbent providers in their service areas, RLECs face the full panoply of regulatory obligations imposed under Title II of the Telecommunications Act and must also comply with COLR obligations as discussed below. While the Act contemplates the possibility that competitive providers might displace incumbents,<sup>120</sup> absent such marketplace shifts, regulatory differences between ILECs and CETCs warrant they be treated differently.<sup>121</sup>

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<sup>117</sup> *E.g.*, Comments of NECA, WC Docket No. 05-337 (filed Apr. 17, 2008) at 22 (*NECA April 2008 Comments*); Reply Comments of NECA, WC Docket No. 05-337 (filed June 2, 2008) at 11; Comments of NECA, WC Docket No. 05-337 (filed Nov. 26, 2008) at 18.

<sup>118</sup> “[I]t is as clear as clear can be that the costs of investing and maintaining wireless and wireline infrastructure are inherently different. I believe that wireless can and should be a part of Universal Service, but the time has come to put an end to the irrational and costly system of supporting wireless carriers based on the cost of wireline incumbents.” Statement of Commissioner Michael J. Copps before the Senate Commerce Committee (Mar. 1, 2007). *See also Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008), Statement of Commissioner Michael J. Copps.

<sup>119</sup> High-Cost Universal Service Support, WC Docket No. 05-337, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1470 (2008) ¶¶ 5, 10.

<sup>120</sup> 47 U.S.C. § 251(h)(2). *See, e.g., Petition of Mid-Rivers Telephone Cooperative, Inc. for Order Declaring it to be an Incumbent Local Exchange Carrier in Terry, Montana Pursuant to Section 251(h)(2)*, Report & Order, 21 FCC Rcd 11506 (2006) (*Mid-Rivers Order*).

<sup>121</sup> *NECA April 2008 Comments* at 13.

The Rural Associations also support the Commission’s near-term proposals to modify its study area waiver process and to eliminate the “parent trap” rule governing exchange acquisitions. These steps will reduce red tape and enable small rural carriers to make progress “edging out” broadband services into currently unserved or underserved areas.

The Commission “froze” study areas in the early 1980’s based on concerns carriers might seek to maximize USF support by isolating high-cost portions from larger areas with lower average costs. While carriers can seek waiver of the rule in specific cases, grant of such requests can take years even in the most noncontroversial of cases.<sup>122</sup>

The NPRM proposes to streamline the process by allowing such petitions to be “deemed granted” 60 days after the comment cycle is complete, absent further action by the Wireline Competition Bureau. This will significantly reduce regulatory red tape while leaving the Commission with adequate flexibility to put a halt to the process and investigate should a particular study area waiver request raise unusual concerns or questions.

The Commission also proposes to modify the standard for evaluating study area waiver requests – and, in particular, to substitute a focus on the public interest benefits of the proposed waiver for the current “one-percent guideline.” The Rural Associations generally support such a

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<sup>122</sup> See e.g., *Partner Communications Cooperative and Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom*, CC Docket No. 96-45, *Joint Petition for Waiver of the Definition of “Study Area” Contained in Part 36, Appendix- Glossary of the Commission’s Rules, Petition for Waiver of Sections 69.3(e)(11) and 69.605(c) of the Commission’s Rules*, Order, DA 06-994 (rel. Apr. 27, 2006) (petition filed in June 2004); *Heart of Iowa Communications Cooperative and Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom*, CC Docket No. 96-45, *Joint Petition for Waiver of the Definition of “Study Area” of the Appendix-Glossary of Part 36 of the Commission’s Rules, Petition for Waiver of Sections 69.3(e)(11) and 69.605(c) of the Commission’s Rules*, Order, FCC 06-29 (rel. Mar. 15, 2006) (petition filed in November 2003).

change to the standard. As the Commission rightly notes, the one-percent guideline has become increasingly irrelevant due to changes in the high-cost USF mechanisms.<sup>123</sup>

The Commission’s proposal to replace the one-percent guideline with a public interest analysis may, however, result in redundant analysis since both the first and third prongs of the Commission’s waiver analysis would now reference this standard. The Commission may therefore more simply evaluate whether the requested waiver is in the public interest, based upon the various factors listed in the NPRM, including number of lines at issue, projected USF cost per line, the extent of cost reductions, efficiencies, or other benefits that are expected to result from consolidation, and the views (if any) of state commissions having jurisdiction over the exchanges at issue.<sup>124</sup>

The Rural Associations likewise welcome elimination of the “parent trap” rule (section 54.305 of the Commission’s rules), although the proposals in the NPRM should be modified further to accelerate broadband deployment in unserved areas. Specifically, the Commission proposes to eliminate immediately application of the “parent trap” rule to any exchanges subject to a study area waiver order adopted five or more years ago and when a certain minimum percentage of the acquired lines (*e.g.*, 30 percent) remain unserved by 768 kbps broadband (presumably downstream), as indicated on NTIA’s National Broadband Map and/or on Form 477 data. The Commission further suggests that for study area waivers issued less than five years ago, the “parent trap” rule would effectively lapse five years after the adoption of the implementing order. And, for study area waivers granted subsequent to the adoption of the implementing order, the “parent trap” rule would expire five years after the adoption of the

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<sup>123</sup> *NPRM* ¶¶ 222-24.

<sup>124</sup> *Id.* ¶ 224.

related study area waiver order. In both cases, a specified minimum percentage of housing units would have to be unserved by broadband.<sup>125</sup>

Some changes and clarifications to these proposals are necessary and appropriate to promote the objective of broadband deployment to unserved consumers. First, the waiting period should be reduced substantially from the proposed five-year period. If the Commission's overarching public policy objective is to inject targeted funding to deliver broadband to unserved areas as soon as possible, customers in areas where an acquisition has taken place should not be forced to wait for up to five years (plus the time involved for construction) to realize the benefits of broadband.

In this case, the shortest route between two points is a straight line. Rather than hoping in a roundabout way that some provider will happen to bid for Phase 1 CAF dollars to deploy broadband on the outskirts of scattered exchanges across rural America, the Commission should enable the providers who already invested to purchase those exchanges in the first instance to deliver on the promise of broadband for them. If the Commission has found a particular study area waiver to be in the public interest (either by granting it or allowing it to be "deemed" granted), it should not only permit but also encourage the new owner to proceed with reasonable broadband deployment to unserved portions of the acquired area as soon as practicable.<sup>126</sup>

Second, the determination of what speeds are available in a given set of exchanges should not be based solely on data acquired from the National Broadband Map and/or on Form 477. As an initial matter, the National Broadband Map remains subject to serious questions with respect to its accuracy.<sup>127</sup> In addition, neither the National Broadband Map nor the Form 477 data

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<sup>125</sup> *Id.* ¶ 226.

<sup>126</sup> *See id.* ¶ 135 (proposing that certain build-out requirements be achieved within three years).

<sup>127</sup> *See supra* note 112, Phoenix Center Policy Bulletin No. 27, Mar. 2011.

measure speeds by individual lines, but rather by census blocks and/or road segments, so their utility in assessing percentages of lines served at certain speeds is spotty at best. Moreover, a provider who acquires a set of exchanges should not be hindered from seeking support based upon potentially incorrect data supplied by the former owner of those exchanges. Thus, the Commission could establish a *rebuttable* presumption as to the “served” nature of such areas by reference to Form 477 data, but it should also enable a provider to demonstrate that the speeds available to a certain percentage of lines in the affected exchanges qualify those areas for elimination of the “parent trap” rule.

#### **IV. THE RLEC PLAN MODERNIZES AND REFORMS THE USE FOR THE LONGER TERM IN A MANNER THAT SATISFIES THE COMMISSION’S PRINCIPLES IN THIS PROCEEDING.**

The RLEC Plan described above appropriately “evolves” today’s RoR-based high-cost support program over the long term, in a manner consistent with the Commission’s principles for reform set forth in this proceeding. First, the Plan achieves the Commission’s desire to “modernize” USF (and ICC) by establishing a clear and well-defined migration from the current cost recovery mechanisms to a broadband-focused CAF. As described above, the Plan would support funding of broadband-capable investments and costs, phasing out over several years the legacy HCLS mechanism. Legacy ICLS would also be phased out in a broadband environment, with such support being received going forward only for those lines that remain “voice-only,” while LSS would be addressed coincident with ICC reform.<sup>128</sup>

This carefully planned transition is a key component of modernization, allowing carriers to use RoR-based cost recovery and existing accounting and ratemaking mechanisms even as

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<sup>128</sup> See *supra* p. 43 (Sec. III. A. 4).

support flows are explicitly “re-purposed” moving forward to enable efficient broadband investment and operations and ensure affordable broadband rates for end-users.

This transition path is also consistent with the Commission’s clearly stated intent to “avoid sudden changes or ‘flash cuts’” in its policies,<sup>129</sup> providing a sound and administratively workable path to the end-state of long-term reform. The Rural Associations are encouraged by the Commission’s desire to avoid disruptions in support that could result in rate shocks, degraded service quality, or worse. RLECs have made significant investments pursuant to current rules, putting at risk private capital that is often backed or leveraged by loans from private entities and federal agencies. The reasonable and prudent transition path in the RLEC Plan would help to ensure that these much-needed reforms do not prevent RLECs from recovering this past investment and repaying government and private sector loans.

Likewise, the RLEC Plan strikes an appropriate balance by imposing constraints on recovery of *future* investment and operations from federal USF mechanisms, while providing a reasonable opportunity for recovery of *existing* investment consistent with current rules. As described above, the RLEC Plan includes staged reforms and several “pause” points – starting three to five years after an implementing order is issued – at which time the Commission can take stock of how the market has responded to its reforms, how technology has advanced, what new broadband services have appeared, and how consumer demands have evolved. This will offer an effective opportunity for comprehensive review and recalibration of reforms as needed, in lieu of locking the Commission into a plan that would likely be quickly surpassed by subsequent marketplace, technological, and/or regulatory developments.

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<sup>129</sup> *NPRM* ¶ 12.



The RLEC Plan's proposed increase in the allocation of loop costs to the interstate jurisdiction over time, as described earlier in these comments, represents another prudent, yet forward-looking, transitional measure.<sup>130</sup> As consumers increasingly adopt broadband services, it is necessary and appropriate to ensure that the costs associated with the networks delivering those services are proportionately shifted to the interstate jurisdiction. At the same time, "flash-cutting" the assignment of loop costs to the interstate jurisdiction would disrupt the current federal-state balance associated with oversight of multi-use, broadband-capable facilities. This could lead to numerous undesirable consequences ranging from an immediate sharp increase in the size of the USF to upward pressure on customer rates.

By basing loop cost allocation on the relative adoption of broadband by each RLEC's customers, it will position federal and state regulators to consider in a more measured manner the ways in which separations reform and the jurisdictional nature of broadband services will affect cost recovery by carriers and the rates they charge to customers for various services.<sup>131</sup> Moreover, in addition to its transitional benefits, this proposal has two other substantial advantages. First, linking interstate cost assignment to the procurement of broadband services by customers will encourage RLECs to stimulate adoption. Specifically, as its subscribers' broadband adoption rate increases, a higher percentage of that RLEC's loop costs would be assigned to the interstate jurisdiction and recovered from the CAF (after applying a wholesale urban broadband benchmark to identify high-cost operations and to ensure a reasonable level of recovery from end-users).

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<sup>130</sup> *See supra* pp. 31-32.

<sup>131</sup> Indeed, while many would prefer to focus on an "end game" in which all services provided over the network are broadband (and perhaps "over-the-top" VoIP), such that the network would be entirely subject to federal jurisdiction, the RLEC Plan's approach reasonably acknowledges that at least during the transition to that "end game," consumers will continue to make some use of services that are firmly within the intrastate jurisdiction.

The second advantage of the RLEC Plan’s proposed transition of costs to the interstate jurisdiction is that it retains the role of states as stakeholders in USF reform. Unlike proposals that would shift all effective responsibility and/or costs directly to the interstate jurisdiction almost immediately, the RLEC Plan provides for a continuing state role as the network evolves to an all-broadband environment.<sup>132</sup>

The RLEC Plan also satisfies the Commission’s principle of “fiscal responsibility” in reform. Before proceeding to discussion of this feature, however, it is important as part of any informed decision-making process to acknowledge the efficiency and effectiveness of the existing high-cost support mechanisms. Although the Rural Associations do not dispute the need to enhance and update these mechanisms going forward, the Commission should recognize that the current high-cost support mechanisms have enabled great success in broadband deployment and adoption in RLEC study areas *at little increased cost to the USF*. Specifically, existing high-cost mechanisms have enabled RLECs to increase their DSL-speed broadband penetration from 81 percent to over 92 percent in the past three years in which NECA has collected such data<sup>133</sup> at a compounded annual growth rate of only about 2.5 to 3 percent per year in USF support.<sup>134</sup> As

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<sup>132</sup> It should be noted that the RLEC Plan also calls for the states to retain their current, substantial role in enforcing federal COLR obligations with respect to broadband. *See infra* pp. 69-75.

<sup>133</sup> *See supra* note 116.

<sup>134</sup> *NPRM* at 59, Figure 7 Although the NBP and its associated Broadband Assessment Model seemed to presume that wireless technology offers the most effective long-term choice for network investments, it is not at all clear that wireless provides the same long-term (or even near-term) “bang for the buck” or that it can serve as a true substitute for, rather than a complement to, a robust wireline network. First, the costs of deploying wireless solutions may not provide any significant savings over a wireline network. *See* Comments of the Nebraska Rural Ind. Companies, WC Docket No. 10-90 (filed July 12, 2010), Appendix A (attaching Vantage Point study). Second, even where near-term savings may be realized in the form of lower capital investment, network efficiency must be evaluated over the life of the network in question rather than how much it costs “today.” As even the most fervent wireless proponents have made clear, wireless spectrum is no match for wireline networks in terms of potential

the NPRM recognizes, the “no barriers to advanced services” policy adopted in the Rural Task Force Order has allowed RLECs to use USF support in a forward-looking manner to construct multi-use networks that support both quality voice *and* broadband offerings.<sup>135</sup>

Moreover, it is often overlooked that high-cost support provides a “dual bang for the buck” by promoting *both availability and adoption*. In addition to promoting network investment in hard-to-serve rural areas, such support is critical to ensuring that services are available at affordable and “reasonably comparable” rates. Similarly, while some assert that the existing ICC regime deters investment in softswitches and advanced networks, as demonstrated earlier, RLECs have been motivated and eager to deploy broadband and convert to IP-enabled networks to the maximum extent possible. Thus, while some may assert that the current high-cost support and ICC mechanisms discourage broadband deployment and adoption, the facts prove otherwise and the Commission should not overlook these successes in structuring its reforms.<sup>136</sup>

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capacity. Third, wireless networks depend on wires – even the best-engineered wireless network depends to a significant degree on making sure that wireless traffic “hops” to a wireline network as soon as possible. *See infra* pp. 83-84. *See also Rural Associations’ July 2010 Comments, Appendix B, Good Engineering Practices Relative to Broadband Deployment in Rural Areas, (Report of the Association of Communications Engineers).*

<sup>135</sup> NPRM ¶ 52. Another aspect of the existing system that has promoted broadband investment in RLEC areas is that most RoR-regulated ILECs offer stand-alone broadband transmission service on a Title II common carrier basis under tariff. The continuation of this tariffed transmission layer is yet another benefit of the RLEC Reform Plan. While the FCC’s authority to explicitly designate non-regulated broadband Internet access service as a supported service may be limited under Sections 214(e) and 254, there is no question that support can be distributed for mixed-use plant that supports both Title I broadband Internet access and Title II regulated telecommunications services. Indeed, to avoid legal challenges with respect to the distribution of high-cost funds to non-carriers in support of the provision of non-telecommunications services (*i.e.*, broadband), it would seem prudent, if not essential, for the Commission to consider requiring *all* recipients of support (*i.e.*, not just RLECs) to be ETCs who offer broadband transmission as a stand-alone service under tariff.

<sup>136</sup> Notwithstanding claims that the current rules discourage operating efficiencies and consolidation (*see, e.g., NPRM* at ¶¶ 148, 217), RLECs engage in a substantial amount of sharing

This is not to say that the current system works perfectly or to deny that the Commission and industry can and should strive to achieve still-greater efficiencies and fiscal responsibility. The Rural Associations acknowledge that the existing mechanisms – and particularly the so-called “race to the top” created by the operation of the cap imposed on the HCLS mechanism – must be modified to promote sustainable broadband investment. The key therefore is for the Commission to take stock of both the successes and shortcomings of the existing framework with laser-like precision, and to focus its reform “scalpel” on just those aspects of the existing mechanisms that are perceived by the Commission as requiring modification to become more efficient and effective. The RLEC Plan offers great promise in this regard, and would encourage “fiscal responsibility” in the investment and operation of networks in several ways. First, the Plan imposes reasonable constraints on the extent to which RLECs recover future capital investment in loop plant from federal USF mechanisms. For example, as described earlier in these comments,<sup>137</sup> the Plan would limit going forward the amount of loop investment that an individual RLEC could undertake in any given year by reference to the level of that RLEC’s own accumulated loop plant depreciation. This measure would address the so-called “race to the top” by placing reasonable, individually-tailored constraints on recovery of an RLEC’s investments from federal USF. At the same time, it would allow for the replacement of and/or upgrades to loop plant, along with the “edging-out” of broadband into unserved areas, as needed to respond

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of resources already that would not occur if the current USF and ICC mechanisms truly supported a guaranteed recovery of costs invested. For example, there are in a number of states today “statewide networks” (such as in South Dakota, Iowa, and Nebraska) that are owned and operated by RLECs (or groups of RLECs) and that have been put in place to, among other things, reduce transport costs; in other instances, such as in Minnesota, several RLECs share equal access tandem switching arrangements or even management teams.

<sup>137</sup> See *supra* pp. 8-9.

to market-driven consumer demands for broadband (consistent with yet another of the Commission’s reform principles).

Similarly, the Plan provides support for recovery of “middle mile” costs – an essential component of a “modernized” broadband-focused support mechanism. But it also ensures that any such support is constrained by reasonable engineering assumptions regarding the network capacity needed to meet the actual broadband demands of the subscriber base located in the applicable “last mile” serving area.

The Plan also further serves the objectives of fiscal responsibility, accountability, and market-driven reforms by imposing greater constraints on recovery of corporate operations expenses from high-cost support than exist today,<sup>138</sup> helping to address concerns (even if not borne out by fact) that have been expressed about the efficiency of RLEC corporate overheads.<sup>139</sup> To be clear, corporate operations expenses are a necessary component of offering affordable, high-quality services to consumers and ensuring compliance with regulatory requirements that govern such services. Eliminating recovery of these expenses altogether from federal support mechanisms is a draconian measure and would be contrary to the interests of rural consumers that the reforms are largely intended to serve. Rather than eliminating all such support for corporate overheads, the Commission could encourage efficiency on the part of service providers, hold them accountable, and make them responsive to market conditions by extending the current cap on corporate operations expense recovery beyond the current HCLS mechanism and applying it to ICLS and LSS, as recommended by the RLEC Plan.

The RLEC Plan would further serve the Commission’s accountability reform objective in other respects. Specifically, as described in greater detail in the section that follows, the Plan

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<sup>138</sup> See *supra* pp. 11-12.

<sup>139</sup> See, e.g., *NPRM* ¶¶ 197-98.

would require each recipient of high-cost support to satisfy strict but reasonable COLR obligations.<sup>140</sup> Even as the Commission has devoted substantial attention to the supposed waste and inefficiency in the current high-cost mechanisms that support RLECs, the real tragedy is that some larger companies that have received many times the support of most small rural providers have failed to invest that funding in the high-cost portions of their study areas.<sup>141</sup> To address such failings, the Commission must require every CAF/USF recipient – RLEC or otherwise – to apply any high-cost support received toward investment in broadband-capable networks in the high-cost portions of its study areas.

Thus, the RLEC Plan makes great strides in addressing, in a reasonable and well-defined manner, the Commission’s principles of reform and its most significant concerns with respect to the current high-cost support mechanisms. The RLEC Plan will also help to constrain the future growth of RLEC high-cost support mechanisms, which have been increasing by only about 2.5 to 3 percent per year on average in recent years. In this regard, the RLEC Plan is designed to be complementary to other reforms envisioned in the NPRM, helping to ensure adequate resources are available to promote broadband deployment in unserved areas throughout the United States.

Finally and most importantly, the RLEC Plan is consistent with the statutory underpinnings of universal service, as expressed in section 254 of the Act. It ensures that sufficient (but controlled), specific, and predictable funding will remain available to enable the delivery of reasonably comparable services at reasonably comparable rates for all consumers.

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<sup>140</sup> See *infra* pp. 69-75.

<sup>141</sup> See FCC Response to United State House of representatives Committee on Energy and Commerce Universal; Service Fund Data Request of June 15, 2010, (available at <http://republicans.energycommerce.house.gov/news/PRArticle.aspx?NewsID=7970>).

**V. THE RLEC PLAN SERVES THE COMMISSION’S “ACCOUNTABILITY” PRINCIPLE BY RECOGNIZING THE UNIQUELY IMPORTANT ROLE RLECS PLAY AS “CARRIERS OF LAST RESORT” IN RURAL AREAS.**

The RLEC Plan carries forward and adapts to a broadband-oriented universal service program many of the COLR policies and requirements that have worked so effectively to ensure that quality and affordable voice-grade services are ubiquitously available through-out high-cost rural areas. The imposition of strict, but reasonable and well-defined, COLR obligations is essential to ensure accountability in the use of USF dollars, and indeed, such measures should be applied to recipients *throughout* the high-cost program (and not just to RLECs) if the Commission’s core reform objectives are to be achieved.

Existing federal, state and private COLR requirements ensure that a readily-identifiable entity will provide a specified minimum of telecommunications services within a defined service area to all residential and business customers (including other telecommunications carriers) who request and pay for such services. Typical traditional COLR responsibilities (which may vary by state) are outlined in Appendix C to these comments, and generally revolve around the following five elements:

1. ***Duty to serve:*** COLRs must typically extend specified retail telecommunications services to all potential customers within defined service areas at the request of each such customer, subject to reasonable conditions and service quality standards specified by the appropriate regulatory authority. During recent years, specified retail services have included single-line voice service, touch-tone dialing, call waiting, call forwarding, three-way dialing, equal access, toll limitation, toll blocking, SS7 signaling, extended area service, directory assistance, operator services, emergency services, telecommunications relay services, and directory listings and books. As the network completes the transition to a broadband network, specified retail services will need to expand to include broadband and other advanced services.
2. ***Line extensions:*** COLRs are typically required to extend distribution networks throughout defined service area (including unserved and newly settled areas) at the request of new applicants for service, subject in some states to reimbursement by such new applicants for certain construction costs (for example, tariffed and regulated

Contribution in Aid of Construction charges that cover some or all of the cost of a line extension).

3. ***Exit barriers:*** COLRs must continue providing service to customers within defined service areas unless and until the relevant regulatory authority grants permission to exit (for example, by approving a new owner in the event of a voluntary assignment or transfer of control, or by locating and designating one or more successor COLRs in the event of a bankruptcy or insolvency).
4. ***Other retail obligations:*** A COLR may be subject to mandated rate designs for residential, single-line business and multiple-line business customers, as well as mandated discounts for low-income and disabled customers.
5. ***Carrier-to-carrier obligations:*** A COLR may be required to furnish certain interconnection and wholesale services needed by other carriers, including special access circuits that provide connections and backhaul for wireless towers.

COLR functions render substantial service availability and service continuity benefits that are essential to public health, safety and welfare. However, they entail major and continuing financial burdens for individual COLRs. First and foremost, COLRs are subject to expensive obligations to invest in, construct, operate and maintain network facilities to serve all of the customers located within their defined service areas who might request service. Whereas virtually any service provider will serve profitable customers, the essence of COLR status is the requirement for the carrier to disregard normal business and economic considerations, and to construct facilities and provide service anyway to customers whose remote locations, high costs of service and/or minimal profit potentials would not normally induce a profit-maximizing entity without COLR obligations to offer them service at readily affordable rates.

Moreover, in addition to the substantial and continuing additional investments and expenditures necessary to serve remote or otherwise less desirable customers, COLRs are subject to a host of associated regulatory requirements that include quality of service standards, and federal and state oversight of their rates, costs, accounting methods, record keeping and customer relationships.



Section 214(e) of the Act establishes comprehensive COLR status and responsibilities for recipients of federal high-cost support. Section 214(e)(1) requires each common carrier designated by a state commission or the Commission as an ETC for the purpose of receiving universal service support: (a) to offer the services supported by the applicable universal service support mechanisms throughout its specified service area; and (b) to advertise the availability of such services and its charges for them using media of general distribution.

In other words, section 214(e)(1) makes an ETC a COLR by requiring it to offer the supported services (either using its own facilities, or using a combination of its own facilities and resale of another carrier's services) to all customers within its designated service area that request service. Moreover, section 214(e)(3) requires the Commission with respect to interstate services (and state commissions with respect to intrastate services) to determine which common carrier or carriers are best able to provide service to an unserved community (or portion thereof) that has requested service, and to order such carrier or carriers to provide service as ETCs (and, consequently, as COLRs) within the subject area. Finally, section 254(e)(4) allows an ETC to relinquish its designation and terminate service within a particular area, only if there is at least one remaining ETC (*i.e.*, a COLR) that can and will provide the supported services to the affected customers.

Section 214(e)'s ETC requirements were superimposed upon an extensive and well-tested body of specific COLR mandates that had been adopted and implemented during the 20<sup>th</sup> Century in state statutes, state certificates of authority to provide local exchange service (for example, certificates of public convenience and necessity), and state commission regulations. COLR obligations also have been included in the service covenant provisions of RUS loan

agreements (and those of its predecessor, the Rural Electrification Administration), as well as in the by-laws of many rural telephone cooperatives.

The need for and benefits of COLRs have not decreased with the introduction of competition into the local exchange business since the passage of the Telecommunications Act of 1996, or with the evolution of the existing multiple-use network into a predominately broadband network. Nor are they likely to diminish or disappear with the completion of the ongoing transition to a broadband network. No matter how many carriers are willing to serve the more densely-populated and lower-cost portions of a particular area, universal service requires the presence of a clearly identified carrier in each service area that is ready, willing and able to serve the most expensive, least profitable customers therein. Indeed, the Commission should demand as much of recipients of high-cost USF/CAF dollars if it is truly interested in accountability. Likewise, public health, safety and welfare require committed and reliable COLRs that can be counted upon to continue operating or to restore service quickly after major storms, disasters, and other emergency situations.

RLECs have been COLRs for most or all of their existence. The Commission can readily determine from state commissions that the vast majority of these RLECs have an excellent record over the decades of meeting their COLR obligations, notwithstanding the high costs of such obligations, the challenges posed by their service areas, and their limited size and financial resources. In fact, RLECs have long been, and remain, the ultimate and pre-eminent COLRs in that they serve remote, rugged and sparsely populated farming, ranching, mining, forest, mountain and desert areas that the former Bell System and larger independent telephone companies declined to serve (and often continue to seek to sell or spin off) and that many cable television operators and wireless carriers still do not serve.

In addition to providing quality services at affordable rates in sparsely populated rural areas comprising nearly 40 percent of the nation's land mass, RLEC COLRs have an equally excellent record of providing continuing service, or restoring service quickly, after severe natural or man-made disasters have disrupted life in their local service areas. Since 1984, these RLEC COLR efforts and successes have been made possible by the cost recovery and essential support provided by federal high-cost support mechanisms and ICC.

The RLEC Plan will enable the Commission to transition existing high-cost support mechanisms, along with revenues lost as part of ICC reform, to the CAF while preserving existing COLR responsibilities and benefits and extending them to a broadband-driven communications environment. The RLEC Plan recognizes that most RLECs have not yet completed the task of extending broadband facilities and services to all of the customers in their service areas. Equally important, it acknowledges that RLECs need continuing high-cost USF support to service outstanding loans incurred to deploy the facilities necessary to meet their past and present COLR obligations, and to offset the above-average costs of operating and maintaining their existing and future broadband-capable, multi-use networks.

The Rural Associations understand that the Commission is under substantial pressure to increase broadband deployment in rural areas where larger carriers claim they have insufficient incentives to serve. However, such deployment should not be financed by "redistributing" to larger carriers high-cost support dollars needed by RLECs to pay for their existing and future COLR facilities and obligations. By establishing an efficient and orderly transition from existing high-cost universal service mechanisms for RLECs to a specific, predictable and sufficient RLEC-specific mechanism within the CAF, the RLEC Plan ensures that RLECs' fulfillment of

their COLR responsibilities will not be impaired as the Commission adapts its universal service mechanisms for a broadband world.

Finally, the Rural Associations also understand – and support in concept – the Commission’s consideration of potential coverage and service obligations as a significant and tangible measure of accountability.<sup>142</sup> RLECs invest and operate in places that have been historically left behind, and are community-based providers that are committed to delivering the highest-quality services to their customers/neighbors. They are committed COLRs eager to deliver on reasonably designed service obligations. Unfortunately, it is difficult, if not impossible, to arrive at specific proposals (*e.g.*, a CAF recipient would be required by Date X to deliver broadband of Speed Y to Z percent of the households in a given service area) without knowing what reforms might be adopted and obtaining better visibility into funding levels and expectations as to supported broadband speeds.

As noted elsewhere herein, RLECs have made significant strides in deploying DSL-capable broadband (at varying speeds) to all but a relatively small percentage of the customers in their service area. But even these existing investments are at risk – and it will be difficult for RLECs to maintain even these existing services – if the proposed near-term reforms are adopted. This means that the potential for “backsliding” (*i.e.*, the idea that areas that are “served” today might become “unserved” tomorrow as a result of reforms) must be factored into any calculation of coverage or service requirements. Moreover, the RLEC Plan has been calibrated to support the reasonable upgrade over time of existing networks and the measured “edging out” of broadband over time “deeper” into unserved portions of RLEC study areas precisely because the Commission has expressed significant concern about growth in the size of the Fund. If the

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<sup>142</sup> See, *e.g.*, NPRM ¶¶ 124-136.

Commission wants a quicker pace of deployment or upgrade, RLECs are ready, willing, and able to deliver – but they can only do so *if* there is adequate support associated with operating in these hardest-to-serve areas. Thus, the Rural Associations look forward to working with the Commission to develop specific broadband coverage and service commitments that are pegged to *funded* mandates and that are coordinated with the confines and contours of a reformed USF/CAF.

## **VI. THE RLEC PLAN AVOIDS PITFALLS ASSOCIATED WITH USING REVERSE AUCTIONS AND/OR FORWARD-LOOKING COST MODELS AS A REPLACEMENT FOR AN RLEC SUPPORT MECHANISM BASED ON ACTUAL COSTS.**

The NPRM proposes that for Phase I of the CAF, which is intended to be a fast-track interim program, reverse auctions be used to provide non-recurring funding for broadband investment in rural areas that do not presently have even minimal broadband service. Importantly, Phase I CAF support is proposed as a supplement, not a replacement, for existing cost-based RLEC support mechanisms.

As a longer-term vision, however, the Commission seeks to transition all remaining high-cost funding to the new CAF,<sup>143</sup> with support based either on auctions or by offering existing COLRs a “right of first refusal” to support payments determined via forward-looking cost models.<sup>144</sup> The NPRM also suggests such methods might only be applied to a subset of areas, such as those served by price cap companies, maintaining cost-based support to RLECs subject to several potential modifications.<sup>145</sup> In this regard, the NPRM appears to recognize

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<sup>143</sup> *Id.* ¶ 398.

<sup>144</sup> *Id.* ¶ 400.

<sup>145</sup> *Id.* ¶ 401. These modifications may include additional caps, incentive regulation methods, more rigorous regulatory review of investment decisions under the “used and useful” standard, and potential review of the current percent authorized rate-of-return.

appropriately that indeed “one size does not fit all.” Substantial differences between RLEC and non-RLEC financial resources, investment incentives, network designs and deployments, and service areas clearly warrant separate high-cost support mechanisms for different sizes and classes of carriers. The availability and affordability of broadband access *throughout* rural America is too important to hinge on untested theories that will in the end encourage service providers to cut corners on service availability or quality just to turn a profit in areas where it can be hard to eke out any business case for delivery of broadband.

**A. The Record Demonstrates Reverse Auctions Will Not Achieve Congressional or Commission Goals for Universal Broadband Service.**

Over the past decade, substantial evidence has been provided in the record of this and other proceedings demonstrating the harm that would accrue to rural consumers and the carriers that serve them if reverse auctions were implemented. Commenters have cited numerous reasons why reverse auctions will not work, and proponents of reverse auctions have been unable to offer any relevant real world examples of successful application in circumstances similar to the way they would be utilized to provide universal broadband service support in the United States. Briefly, the pitfalls and concerns regarding reverse auctions are as follows.<sup>146</sup>

**1. Reverse auctions will encourage a “Race to the Bottom” that could result in serious service quality problems, contrary to section 254 of the Act.**

Reverse auctions reward bidders who offer to provide service at the lowest cost. While ensuring efficiencies is a laudable goal, a “race to the bottom” neither serves notions of efficiency nor the statutory principles of universal service. In an attempt to win an auction and receive some high-cost support, rather than none at all, overzealous and unscrupulous bidders may be motivated to submit bids that are far lower than what is actually needed to provide

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<sup>146</sup> See generally, *Rural Associations’ July 2010 Comments* at pp. 21-28.

sustainable, affordable services for the long-term.<sup>147</sup> At best, quality of service deteriorates and end-user rates increase; at worst, service disappears. The latter is a potent reality in RLEC service areas, where RLECs are the COLRs because no other entities have been willing to serve these entire regions.

**2. Reverse auctions will generate significant unpredictability for both carriers and lenders, which will inhibit network investment.**

Telecommunications networks require large investments in long-lived infrastructure, and without a reasonable expectation that these costs can be recovered, needed upgrades will not be made. A reverse auction undermines the normal incentives for investment in high-cost, sparsely populated areas because there is no assurance that the provider will have a reasonable opportunity to recover initial or on-going costs. A provider in such a situation would be loath to make investments necessary to enable evolving services, especially if the auction term is near its end.<sup>148</sup>

Investor concerns were recently made evident in an *ex parte* filed by CoBank.<sup>149</sup> In pertinent part, CoBank explains it views elimination of RoR regulation for its RLEC customers “as a serious threat to their ability to obtain access to debt capital.” The investment community

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<sup>147</sup> This phenomenon has already been noted in universal service reverse auctions held in other countries. In Peru, for example, “some winning firms did not meet their rollout obligations. Assuming corruption was not a factor, a ‘winner’s curse’ might have left firms unable to provide service profitably. That is, the winning firms may have underestimated the costs of meeting the obligations and bid too little.” Wallsten, Scott, *Reverse Auctions and Universal Telecommunications Service: Lessons from Global Experience*, *Federal Communications Law Journal*, Vol. 61, No. 2, at 392 (available at [www.law.indiana.edu/fclj/pubs/v61/no2/9-WALLSTENFINAL.pdf](http://www.law.indiana.edu/fclj/pubs/v61/no2/9-WALLSTENFINAL.pdf)).

<sup>148</sup> The matter of cost recovery also haunts auctions with longer terms because winning bids would be unable to account for changes in technology and customer expectations that are certain to occur over time.

<sup>149</sup> Letter from Sarah Tyree, CoBank, to Marlene Dortch, FCC, CC Docket No. 96-45, Attachment at 1 (filed Apr. 5, 2011).

clearly views the possibility of changes to existing support mechanisms as significant negative in analysis whether to extend debt capital to RLECs. Yet these sources of investment capital are vital to RLECs and the customers who depend upon them. Uncertainty associated with reverse auctions would, at a minimum, increase the cost of capital significantly for RLECs and, in many cases, force carriers to forego broadband deployment and upgrade projects in high-cost areas.

**3. Enforcement of service quality standards is difficult under an auction mechanism.**

Enforcement of service quality standards is particularly challenging in an auction environment. RLECs today have incentives to invest in order to maintain and upgrade the quality of their services where sufficient cost recovery mechanisms are available to supplement end-user revenues. As noted above, entities providing service in remote areas pursuant to a winning auction bid are incented to cut costs to the greatest extent possible, even at the expense of service quality, leaving customers wholly dependent on regulators to monitor whether minimum performance requirements are being met. The result will be a nightmare for regulators, requiring a far greater expenditure of time and financial resources than would be needed under a cost-based support mechanism.<sup>150</sup>

**4. Reverse auctions may leave rural areas without suitable COLRs if auction winners fail to meet universal service obligations.**

Another significant risk of reverse auctions is that a backup carrier may not exist to take over the role of COLR should an auction winner fail. By the time it is determined the winning bidder is not performing satisfactorily, the previous COLR – i.e., the RLEC – may be irreparably harmed by the loss of high-cost support and therefore have diminished ability to re-engage and unable to step back in to provide service to the highest-cost customers. In some cases, the

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<sup>150</sup> The NPRM appears to recognize that under a reverse auction mechanism inspections “in the field” would be necessary. *NPRM* ¶ 370.



RLEC, absent sufficient support, may no longer be a viable entity and may seek to exit the market entirely.<sup>151</sup> In all events, there could be no basis for the Commission (or state commissions) to impose COLR obligations for voice or broadband services on RLECs that are not auction winners.

Furthermore, allowing bidders to define service areas<sup>152</sup> implicates additional concerns. For example, what should be done in the instance of a winning bidder for a relatively large service area that provides satisfactory service to one portion of the area, but not to another? A provider could find its support award is sufficient to serve the more populous part of the service area, but not the more remote, higher-cost portion.

**B. Offering Current COLRs a “Right of First Refusal” Based on Forward-Looking Cost Model Results Will Not Resolve Universal Service Concerns in RLEC areas.**

The Commission’s alternative proposal to offer the current COLR a “right of first refusal” seems to recognize the implicit suitability of the incumbent to augment broadband service in its area. But the proposal to determine the amount of offered support based upon a forward-looking cost model is highly problematic for RLECs. While the Commission indicates that development of a model would be open and transparent, and would provide “ample opportunity for interested parties to participate and verify model results,” experience gained with prior modeling efforts suggests this will be difficult to achieve.<sup>153</sup>

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<sup>151</sup> This possibility suggests that in administering any reverse or procurement auction approach, the Commission must take into careful consideration the extent to which bidders intend to rely on existing COLR networks when considering bids from non-ILEC providers for the provision of broadband services in rural areas. As support to incumbent providers is withdrawn or phased out, these networks likely will not be available for backhaul or other functions necessary to support alternative network services.

<sup>152</sup> *NPRM* ¶ 445.

<sup>153</sup> *Id.* ¶ 432.

Pursuit of a model that can address the many variables of RLEC service areas is a Sisyphean task: the vast range of circumstances endemic to these areas has disabled such efforts in the past. It is not clear that even advanced modeling techniques can account adequately for the needs associated with providing broadband in the highly varied farming, ranching, mining, mountain, desert and forest areas served by RLECs.

In sum, the use of reverse auctions or a forward-looking cost model as the basis for a high-cost support mechanism for RLEC service areas would be inherently unstable and unpredictable, and would not ensure “reasonably comparable” services and rates for consumers living in these rural areas. Therefore, these types of mechanisms should not be pursued as a long-term vision for how the CAF operates in RLEC service areas. Instead, as discussed previously, an RLEC-specific component of the CAF based on carriers’ actual costs, as proposed in the RLEC Plan, will satisfy both the Act’s statutory requirements for universal service as well as the Commission’s principles for reform.

**C. Even If a Reverse Auction Mechanism Is Used Only to Determine Supplemental Support Under Phase I of the CAF, It Still Must Conform to Section 254 of the Act.**

The Rural Associations recognize that the Phase I CAF support mechanism described in the NPRM is intended to provide only supplemental support for unserved areas, perhaps primarily outside RLEC service areas. Nevertheless, the NPRM’s proposals in this regard contain several features of concern.

Specifically, the Rural Associations: (a) oppose the distribution of high-cost support on any basis other than pursuant to the express statutory requirements of sections 254(e) and 214(e) of the Act, and particularly any distributions to entities that are not telecommunications common carriers via forbearance from such statutory requirements; (b) oppose the limitation of high-cost support to one carrier per market, because such limitation will preclude rural residents from

having access to broadband services that are reasonably comparable to those available in urban areas where residents have access both to high-speed fixed broadband services *and* lower-speed mobile broadband services; and (c) oppose the “service area aggregation” and “package bidding” procedures proposed for the Phase I CAF auctions because they unduly favor large carriers over smaller ones.

**1. High-cost support must be distributed only to common carriers.**

Section 254(e) of the Act expressly specifies and limits the authority of the Commission and its agents to distribute high-cost support, stating clearly that “[a]fter the date on which Commission regulations implementing this section take effect, *only* an eligible telecommunications carrier designated under section 214(e) shall be eligible to receive specific Federal universal service support [emphasis added].” Section 214(e)(1) of the Act reiterates this same express limitation upon the Commission’s high-cost support distribution authority, declaring “[a] common carrier designated as an eligible telecommunications carrier under [sections 214(e)(2) or (3)] shall be eligible to receive universal service support in accordance with section 254....”

The NPRM nevertheless asks whether it might be possible for the Commission to forbear from section 214(e) of the Act in order to allow non-common carriers to participate in support programs.<sup>154</sup> The forbearance provisions of section 10 of the Act were adopted to give the Commission the discretion to eliminate or ease certain statutory or Commission-imposed regulatory burdens upon telecommunications carriers under certain circumstances. These forbearance provisions were not intended to give the Commission the discretion to eliminate or

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<sup>154</sup> *Id.* ¶¶ 61-62.

ease any of the statutory obligations or responsibilities or limitations placed by Congress upon the Commission itself.

Sections 254(e) and 214(e) are not subject to section 10 forbearance because they are delegations of specific and limited authority to the Commission and its agents regarding the distribution of federal high-cost support, rather than statutory regulations of telecommunications carriers and/or telecommunications services. Unless and until Congress modifies sections 254(e) and 214(e), those statutory provisions plainly require the Commission to distribute existing and future high-cost support solely and entirely to common carriers that have been designated as ETCs by the state commission having jurisdiction over their service areas (or, in the narrow cases covered by section 214(e)(6), by the Commission).<sup>155</sup>

In contrast, the RLEC Plan contemplates distributions only to telecommunications carriers to support the provision of broadband transmission services offered on a common carrier basis. As described above, the broadband transmission services supported under the RLEC plan will include end-to-end connectivity from end users to the Internet backbone, including necessary “middle mile” and Internet backbone connections. While such facilities have not previously been included in support mechanisms, there can be no question that transmission services between end users and the Internet can be offered on a common carriage basis and may fall within the services supportable under section 254 of the Act.

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<sup>155</sup> In addition, the more general Section 706 of the Act does not address or expand the Commission’s express and limited authority to distribute universal service support. Rather, it requires the Commission to conduct regular inquiries of the availability of advanced *telecommunications* capability to all Americans (and particularly schools and classrooms), and (where such deployment is found not to be reasonable and timely) authorizes the Commission to remove barriers to infrastructure investment and to promote competition in *telecommunications* markets. Likewise, as recently reiterated in *Comcast Corp. v. FCC*, 600 F.3d 642 (D.C. Cir. 2010), the Commission cannot exercise its ancillary Section 4(i) jurisdiction in a manner that is inconsistent with its express and statutorily mandated responsibilities in Sections 214(e) and 254(e) and other specific provisions of the Act.

**2. Support should be provided to one fixed broadband network and one mobile broadband network in each high-cost area.**

The Rural Associations understand that the Commission is trying to conserve the resources of the industry-generated USF by proposing to limit support to one carrier per service area.<sup>156</sup> Given that most households and businesses in urban areas have access to affordable fixed and mobile broadband services, the Rural Associations believe that the “reasonable comparability” requirement of section 254 warrants establishment of high-cost support mechanisms for both a fixed broadband network and a mobile wireless broadband network in each qualifying high-cost service area, even if this requires recognition of potential differences in capacity between the two technologies.

Notwithstanding media stories about “cutting the cord,” the substantial majority of American households and businesses in urban and suburban areas continue to subscribe to both fixed and mobile voice and broadband services. Fixed and mobile broadband services presently utilize different equipment and technologies (in most cases), and are used by customers for different purposes and at different times and places. For example, a person may need to use higher-capacity and larger-screen fixed broadband services at work and at home, but be satisfied with lower-capacity and smaller-screen mobile broadband services while “on the go.” The trade-offs that customers must make regarding speed, capacity, file size, screen size and mobility as their needs and circumstances change during the day mean that fixed and mobile broadband facilities and services play separate but complementary roles now and will continue to do so in the future.

Most importantly, residential and business customers in high-cost rural areas have the same needs for both higher-capacity, larger-screen fixed broadband services and lower-capacity,

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<sup>156</sup> *NPRM* ¶ 281.

smaller-screen mobile broadband services as their urban counterparts. In fact, rural residents and businesses will increasingly require reasonably comparable fixed AND mobile broadband services in order to participate in the 21<sup>st</sup> Century economy and society. Thus, provision of support to both fixed and mobile network providers assures compliance with the Act's requirement for reasonable comparability between urban and rural areas.

In addition to providing essential service flexibility for consumers, the complementary nature of fixed and mobile services allow both wireline and wireless carriers to construct and operate more reasonable and efficient networks.<sup>157</sup> For example, wireline carriers provide the high-capacity special access lines connecting many wireless towers with each other and with regional and national networks. Moreover, these carriers transport high volumes of data and video traffic that would clog or cripple wireless networks if they were required to carry it on their own facilities. The Commission is well aware of the congestion and call completion problems caused by iPhones and other emerging devices on wireless networks, as well as the similar problems arising when events or emergencies cause spikes in wireless traffic in certain

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<sup>157</sup> See, e.g., "Regulatory Principles and Policy Priorities 2.0," Remarks of Commissioner Meredith Attwell Baker at The Free State Foundation's Third Annual Winter Telecom Policy Conference (Feb. 4, 2011) ("One area that warrants greater attention in Washington is the increasingly hybrid nature of mobile broadband networks. Many of our devices have the capability through Wi-Fi and femtocells to expand the power and reach of our communications by offloading mobile data onto our terrestrial networks as quickly and efficiently as possible. Last year 21 percent of smartphone traffic in the United States was offloaded, relieving one-fifth of the congestion pressure on our wireless networks. Other nations are seeing much higher levels of offloading. As this figure grows significantly over time, we need to address it head-on. For policymakers, we need to make sure our policies promote the most efficient use of wired and wireless broadband, and that we embrace new technologies that place a premium on efficiency. We need to start having discussions about networks as the true hybrids they are. Whether home or on the road, we incorporate both wired and wireless technologies on a daily basis, and sharing of the terrestrial foundation is critical to address spectrum exhaustion.").

areas.<sup>158</sup> By carrying high-volume traffic between computers and other fixed business and household appliances, wireline networks prevent wireless carriers from having to construct and maintain thousands of additional towers and transmission facilities (if they could obtain zoning approval for the sites). As a result, wireless carriers are able to focus their networks upon the highways, business districts, shopping malls, parks, campuses and other places where people congregate and need connections for their portable broadband devices.

Over the long term, readily scalable fixed broadband networks and targeted mobile broadband networks can be expected to provide efficient and economic broadband services to all Americans as broadband services and uses expand and evolve. Therefore, the Rural Associations continue to advocate the provision of high-cost support to one fixed broadband network and to one mobile broadband network in each qualifying service area so that the residents thereof can have access to a complement of broadband services that are reasonably comparable to those available in urban areas.

### **3. Phase I CAF bidding procedures should not unduly favor large providers.**

The Commission proposes to identify unserved areas on a census block basis and to offer high-cost support for broadband deployment to bidder-defined service areas, which could be

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<sup>158</sup> Indeed, recognition of the limits of mobile broadband comes from surprising sources. *See, e.g.,* An Open Letter to the USA Today Editorial Board from Steve Largent, President & CEO, Aug. 19, 2010 (“You’ve heard us say that wireless is different. Due to the science and physics of spectrum use, there is only so much capacity that is available. This differs dramatically from landline and cable broadband service. One strand of fiber has more capacity than the entire electromagnetic spectrum. So even if we were able to get all the spectrum available in the U.S., we still wouldn’t be able to have the same capacity as a single strand of fiber. To put it another way, it was recently stated that while the theoretical top speed of a LTE (a new wireless 4G technology) carrier is 100 Mbps, the theoretical transmission speeds on fiber can reach as high as 25,000,000 Mbps. That is a stark difference.”); Joan Marsh, *Wireless Is Different*, AT&T Public Policy Blog (Aug. 13, 2010) (available at <http://attpublicpolicy.com/government-policy/wireless-is-different/>).

individual census blocks or aggregations of census blocks.<sup>159</sup> The NPRM also contemplates comparing auction applications and selecting winners by “ranking bids by price per unit covered.”<sup>160</sup>

At the time it drafted and enacted the Act, Congress carefully considered and specified how “service areas” would be defined and determined for the purposes of distributing federal high-cost support. Congress expressly gave the power to define supported “service areas” to the state commissions, declaring in section 214(e)(5) that the “term ‘service area’ means a geographic area established by a State commission for the purpose of determining universal service obligations and support mechanisms.”<sup>161</sup> Congress could have just as easily given the Commission the power to determine the areas throughout which federal high-cost support recipients must serve. However, it plainly decided to grant this power to the state commissions which were more likely to be aware of the particular service needs and circumstances within their states.

Not only does the Commission lack statutory authority to define or specify the service areas that federal high-cost support recipients are obligated to serve, it also has absolutely no statutory authority or justification to delegate to potential CAF auction bidders or other private entities the power to define or self-define such service areas.

Section 214(e)(5) also places a critical limitation upon the power of state commissions to define “service areas” in areas served by rural telephone companies. It declares that “[i]n the case of an area served by a rural telephone company, ‘service area’ means such company’s ‘study area’ unless and until the Commission and the States, after taking into account

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<sup>159</sup> *NPRM* ¶ 289.

<sup>160</sup> *Id.* ¶ 338.

<sup>161</sup> *Id.* at 116, n. 518.



recommendations of a Federal-State Joint Board instituted under section 410(c), establish a different definition of service area for such company.”

In other words, unless and until appropriate action is taken by the Commission and the state commission having jurisdiction over a particular rural telephone company, federal high-cost support must be distributed in that rural telephone company’s service area on a study area basis. The Commission has no statutory authority to unilaterally change the distribution of federal high-cost support in rural telephone company study areas either to an individual census block basis, an aggregated census block basis, or to any other non-study area basis.

In addition, the proposal to determine support recipients in the Phase I CAF reverse auction by “ranking bids by price per unit covered” will decisively favor large carriers over smaller entities.<sup>162</sup> AT&T, Verizon, Sprint Nextel and other large national and regional wireless carriers have the size and purchasing power to negotiate the most favorable and least expensive per-unit terms possible for construction contracts and bulk equipment purchases. In addition, these large carriers enjoy substantial economies of scale that can further reduce the per-unit costs of their planning, overhead and other capital expenditures. As if these advantages were not sufficiently decisive, the bidder-designated service area proposal (if determined to be lawful, for any reason) will allow large carriers to aggregate census blocks in virtually any manner they wish so that they can maximize their already considerable reverse auction advantages. Put simply, the proposed “ranking bids by price per unit covered” mechanism appears to ensure that AT&T, Verizon and other large national and regional carriers will receive virtually all the initial Phase I CAF support they want if this auction method is used.

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<sup>162</sup> *Id.* ¶ 338.

Indeed, both the NTIA and the RUS rejected a similar proposal by “71 Concerned Economists” that they distribute broadband stimulus funding under the Broadband Technology Opportunities Program (“BTOP”) and the Broadband Initiatives Program (“BIP”) via a reverse procurement auction that allowed participants to bid on geographic areas of their own choosing.<sup>163</sup> NTIA and RUS elected instead to evaluate and select BTOP and BIP proposals on the basis of quantitative and qualitative factors (such as project purpose, benefits, viability, budget and sustainability) rather than the lowest per-unit costs proposed for areas gerrymandered by large carriers.<sup>164</sup> As a result, the BTOP grants and BIP grant/loans appear to have been distributed equitably to a varied group of large, mid-sized and small entities.

Some may view “ranking bids by price per unit covered” as an efficient approach because it may enable large carriers to cover more portions of the national broadband service map. However, coverage is not service, and is particularly not quality service. To date, the history of rural telecommunications service has demonstrated consistently and conclusively that small carriers are far more willing than their larger counterparts to invest in and maintain quality rural networks, deploy cutting edge services, employ sufficient local customer service and technical personnel, and remain sensitive to the needs of their rural customers. For a small carrier, the local rural community and surrounding farms and ranches constitute a primary market. For a larger carrier, the same area is likely to be considered a backwater that has no material impact on its financial statements or stock price and which they have historically exhibited little or no

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<sup>163</sup> See *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *High-Cost Universal Service Support*, WC Docket No. 05-337, Notice of Inquiry and Notice of Proposed Rulemaking, 25 FCC Rcd 6657 (2010). The *NOI and NPRM's* Appendix B attached a document entitled “Comments of 61 Concerned Economists, Using Procurement Auctions to Allocate Broadband Stimulus Grants” (Apr. 13, 2009); Erratum (rel. Apr. 30, 2010 (replaced “Appendix B: Comments of 61 Economists” with Appendix B: Comments of 71 Economists.”)

<sup>164</sup> Comments of The Blooston Rural Carriers, WT Docket No. 10-208 (filed Dec. 16, 2008) at 7.

interest or incentive to serve. Therefore, should the Commission proceed with a reverse auction mechanism to distribute supplemental Phase I support for unserved areas, it should do so in a manner that provides RLECs and other small carriers a reasonable opportunity to compete for the support.

**VII. THE REQUIREMENTS OF SECTION 254 OF THE ACT, AS WELL AS THE COMMISSION'S OWN BROADBAND GOALS, WILL NOT BE MET BY CAPPING HIGH-COST SUPPORT AT CURRENT LEVELS.**

A key assumption underlying virtually all the proposals in the NPRM appears to be that the nation's broadband goals must be constrained to those that can be accomplished with current high-cost support levels. There is, however, a fundamental inconsistency between the directives in the Act and the insistence that the size of the USF cannot increase. Section 254 provides the overarching statutory framework for USF reform. Once the Commission defines the broadband network and services that will be supported by federal universal service support mechanisms, it is directed by sections 254(b) and (e) to preserve *and advance* universal service via “specific, predictable, and sufficient” support mechanisms.<sup>165</sup> Section 254 (b)(3) goes on to state that consumers in rural and high-cost areas should have access to telecommunications and information services, including advanced services that are reasonably comparable to those provided in urban areas and at reasonably comparable rates. On the other hand, the law does *not* state that there cannot be any growth in the size of the USF.

The Commission recognizes that ubiquitous broadband infrastructure is crucial to our nation's economic development and civic life,<sup>166</sup> and that as many as 24 million Americans

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<sup>165</sup> 47 U.S.C. §§ 254(b)(5), (e).

<sup>166</sup> *NPRM* ¶ 3.

currently live in areas where there is no access to any broadband network, fixed or mobile.<sup>167</sup>

The Commission states in the NPRM that it wishes to “ensure that all Americans have access to modern communications networks so that we can continue to work together to build on the past success of universal service.”<sup>168</sup> Yet the Commission seems unwilling even to recognize that existing funding levels may not be sufficient to meet these goals.<sup>169</sup>

The Rural Associations likewise recognize the funding available for supporting broadband networks and services is not unlimited. However, the Commission must balance between its desire to minimize contribution burdens imposed on households nationwide and the need to avoid detrimental impacts on rural consumers as well as achieving reasonable comparability between rural and urban areas. Tomorrow’s broadband networks cannot be built on a crumbling foundation of today’s narrowband revenues. At some point, the Commission must confront the fact that high-cost support at current levels will not provide sufficient funding to accomplish the nation’s broadband goals. Rather than balance competing goals, the scale is presently tipped, such that concerns over fund constraints far outweigh overarching national deployment goals and very clear legislative directives regarding what the USF is expected to achieve.

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<sup>167</sup> *Id.* ¶ 5.

<sup>168</sup> *Id.* ¶ 13.

<sup>169</sup> To its credit, the NPRM does ask whether, in light of the high costs required to deploy ubiquitous mobile coverage and very-high-speed broadband to every American and the length of the transition to the proposed CAF, additional investments in universal service may be needed to accelerate network deployment. *Id.* ¶¶ 275, 414. The answer to that question, most definitely, is yes. However, additional investments are needed not only to accelerate initial network deployment, but also for the critical and ongoing task of maintaining and upgrading broadband networks in high-cost areas, so that services and rates remain reasonably comparable to those in urban areas.

As explained above, the Rural Associations support sensible steps to control the size and growth of the rural high-cost program. The RLEC Plan incorporates reasonable mechanisms to constrain capital expenditures and operational expenses, and is designed overall to continue expansion of broadband services in RLEC territories at a reasonable, market-driven pace at costs comparable to those that would be incurred if existing mechanisms were left in place. The Rural Associations also support elimination of the existing identical support rule, which the record shows does not efficiently promote deployment of mobile voice and broadband services in truly high-cost areas.<sup>170</sup> Finally, the Rural Associations also support limiting funding to no more than one fixed and one mobile ETC per area<sup>171</sup> as well as the Commission's open rulemaking to constrain growth in Lifeline funding.<sup>172</sup>

However, the Commission should also take immediate action to sustain the USF by broadening the base of USF contributors. Broadband Internet access providers collectively represent a large and growing source of connections and revenues as well as overall network utilization.<sup>173</sup> Given that the high-cost program is being reformed to directly support broadband, requiring contributions from all broadband service providers, over all platforms, would more fairly distribute the total cost of the USF. It would also permit the size of the USF to grow

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<sup>170</sup> *Id.* ¶ 242.

<sup>171</sup> *Id.* ¶ 403.

<sup>172</sup> See *Lifeline and Link Up Reform and Modernization*, WC Docket No. 11-42, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Lifeline and Link Up, WC Docket No. 03-109, Notice of Proposed Rulemaking, FCC 11-32 (rel. Mar. 4, 2011). See also Letter from D. Scott Barash, USAC, to Marlene H. Dortch, FCC, CC Docket No. 96-45 (filed Mar. 31, 2011), attaching USAC 2010 Annual Report, at 52 (showing increase in Low-Income support to CETCs).

<sup>173</sup> As of June 30, 2010, high-speed Internet access connections over fixed-location technologies were approximately 82 million, while the total number of high-speed connections over both fixed and mobile wireless technologies as of the end of 2009 was slightly over 153 million. See *Internet Access Services: Status as of June 30, 2010*, Industry Analysis and Technology Division, Wireline Competition Bureau (Mar. 2011).

without imposing an unreasonable universal service fee on any assessable communications service.

The Commission has had an open proceeding on the USF contribution methodology since 2001, and has sought comment on fundamental contribution reform several times.<sup>174</sup> There exists a voluminous record upon which the Commission could make a near-term decision that would allow for modest growth in the Fund without placing an undue or inequitable burden on households nationwide. The Commission should take action on this issue at the earliest possible opportunity. In the meantime, however, it should refrain from basing all universal service reform decisions, including proposals at issue in this proceeding, on the fundamentally flawed

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<sup>174</sup> See *High-Cost Universal Service Support*, WC Docket No. 05-337, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link Up*, WC Docket No. 03-109, *Universal Service Contribution Methodology*, WC Docket No. 06-122, *Numbering Resource Optimization*, CC Docket No. 99-200, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, *IP-Enabled Services*, WC Docket No. 04-36, Order on Remand and Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd 6475 (2008) at 6536-6564, 6669-6695, 6735-6762, App. A, ¶¶ 92-156, App. B, ¶¶ 39-104, App. C, ¶¶ 88-151 (*Comprehensive Intercarrier Compensation and Universal Service Fund Reform FNPRM*); *Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, Public Notice, 18 FCC Rcd 3006 (2003); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, CC Docket No. 98-171, *Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990*, CC Docket No. 90-571, *Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size*, CC Docket No. 92-237, NSD File No. L-00-72, *Number Resource Optimization*, CC Docket No. 99-200, *Telephone Number Portability*, CC Docket No. 95-116, *Truth-in-Billing and Billing Format*, CC Docket No. 98-170, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952 (2002); *Federal-State Joint Board on Universal Service, et. al.*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, Further Notice of Proposed Rulemaking and Report and Order, 17 FCC Rcd 3752 (2002); *Federal-State Joint Board on Universal Service, et al.*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, NSD File No. L-00-72, Notice of Proposed Rulemaking, 16 FCC Rcd 9892 (2001).

assumption that making sustainable, robust broadband service available to all Americans at affordable rates can be accomplished with current funding levels.

## **VIII. CONCLUSION**

The RLEC Plan described in these comments satisfies both the Commission’s near and long-term goals in this proceeding. In the near term, the RLEC Plan proposes specific, targeted reforms designed to address concerns that existing High-Cost mechanisms permit recovery of excessive capital expenditures and operational expenses. The RLEC Plan also proposes a reasonable approach for unifying interstate and intrastate switched access rates.

Longer-term, the RLEC Plan provides an approach for “evolving” existing cost-based RLEC high-cost support and ICC mechanisms via the creation of a new cost-based RLEC-specific broadband support mechanism designed to function as a component of the overall CAF. As explained above, this approach is fully consistent with the Commission’s key principles for USF and ICC reform while, at the same time, ensuring that rural consumers in RLEC service areas can continue to receive reasonably comparable services at reasonably comparable rates consistent with the core statutory principles establishing universal service.

The Commission should not require carriers to disaggregate support or redraw existing study area boundaries at this time, as doing so is unlikely to improve efficiencies and is likely to increase pressure on USF or CAF mechanisms. Nor should the Commission seek to withdraw support from supposedly “competitive” areas without careful consideration of the effects doing so would have on universal service in outlying, non-competitive areas and the implications of such a measure on important COLR obligations.

The Commission should, however, take action to phase-out existing “identical support” for CETCs, streamline the existing study area waiver process, and take action to eliminate the adverse impacts of the “parent trap” rule.

The Rural Associations recognize the complexity of these issues, and appreciate the Commission’s effort in issuing proposals to achieve key and much-needed reforms. The Rural Associations look forward to working closely with Commission staff in the coming months to implement effective and efficient reforms consistent with the recommendations of the RLEC Plan on a timely basis.

April 18, 2011

Respectfully submitted,

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**Appendix A**

**Proposal for Allowed Loop Plant Capital Expenditures  
For High Cost Funding of Future Loop Plant Investments**

April 2011

Vantage Point

# **Proposal for Allowed Loop Plant Capital Expenditures**

**For High Cost Funding of Future Loop Plant Investments**

April 2011



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## 1 The Issue

The Federal Communications Commission (FCC) desires to transition the current Universal Service Fund (USF) into a Broadband Fund while controlling the size of the fund. The FCC has expressed concern regarding the need for efficiency in the use of USF support by rate of return Local Exchange Carriers (LECs), since their USF payments flow to a significant degree from the amount of their investment and therefore may be incented to over invest or invest at too rapid a pace. To address these concerns, the FCC is looking for ways to limit rate of return companies' investment and the rate of that investment. We understand the need for the FCC to manage the fund size and therefore offer this plan as a means to address the FCC's concerns while also giving clear guidance on recovery of future investments.

## 2 Goals

The following goals are important for high cost funding of future investments:

- Universal Service Funds should be used to reach the areas of greatest need.
- Universal Service Funds should be distributed fairly.
- Universal Service Funds should be stable, predictable, and sufficient.

### 2.1 Funds Should Reach the Areas of Greatest Need

LECs managers should be able to make decisions regarding the replacement of facilities when the facilities reach the end of their Economic Life. Once cable and electronics reaches the end of their Economic Life, maintenance costs increase, reliability decreases, and the facility may become non-functional altogether. In addition, it is often difficult, if not impossible, to meet customers' broadband needs over old, outdated facilities that have reached the end of their Economic Life.

### 2.2 Funds Should Be Distributed Fairly

It is important that the new regulatory environment encourage greater broadband deployment at speeds necessary to meet future customer needs. Currently there are no procedures to ensure that fund recipients are receiving an adequate portion of the fund for the areas being served. Some companies are investing more aggressively than others, which limits the funds available to companies

that are investing less aggressively. If investment levels were constrained to the amount needed to replace existing facilities once they reach the end of their Economic Life, the distribution of funds would be considerably more fair and equitable. In addition to the replacement of existing facilities, companies should be allowed to invest in “greenfield” areas. For purposes of this document, “greenfield” areas include any area where there are currently no existing local loop facilities.

### **2.3 Funds Should be Stable, Predictable, and Sufficient**

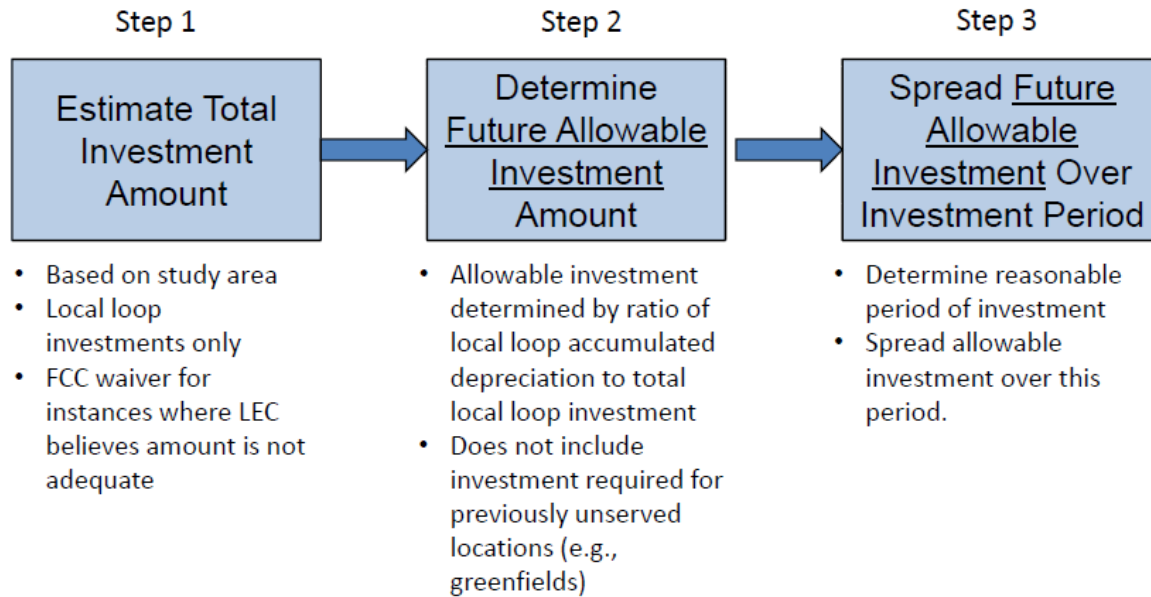
To ensure that the fund remains stable, predictable, and sufficient it is important that the fund’s demand be spread over time. If all fund recipients were to make significant investments over a short period of time, the fund would not be able to properly compensate these recipients without materially increasing the fund size. The method proposed herein is a simple, easily implemented method that will minimize the volatility of the high cost fund by requiring LECs to spread their future investments over a period of time.

## **3 Proposed Allowable Investment Method**

Although there are other capital expenses that must be recovered by a LEC, the methodology described in this paper focuses only on future local loop investments, for three reasons:

1. The local loop represents the majority of a telephone company’s total plant investment – often being 60% or more of their total investment.
2. The local loop investment receives a significant portion of high cost funding
3. Differences in local loop design criteria can result in large variability between one design and another

As shown in Figure 1, the proposal estimates the portion of a LEC’s local loop investment that should require replacement and then spreads this investment over a period of years for purposes of USF recovery.



**Figure 1. Process for Determining Allowed Capital Expenditure**

### **3.1 Step 1: Estimate the Total *Investment Amount***

Numerous factors contribute to local loop investment cost. Customer density is the most important cost driver, but other factors such as terrain characteristics (soil resistance or presence of rocks), existing underground utilities, weather factors (number of rain or frost-free days), access to poles and right of way, environmental restrictions (parks, historical areas or protected species), and local codes (cable depth requirements) also affect cost. Many methods have been proposed to estimate a LEC's local loop *Investment Amount* including the following:

- A detailed engineering analysis of each support area
- A regression equation relating cost with independent variables that contribute to cost
- A hypothetical model
- Category 1, Category 2, Category 4.11 and Category 4.13 local loop investment from a LEC's financial records, adjusted for inflation and other factors

Any of these methods would provide an estimate of the total investment required. As with any estimate, none of these methods will yield the *exact* investment amount. Each method has its advantages and disadvantages, but that discussion is beyond the scope of this paper. Regardless of the method, there should be a simple safety valve waiver process for instances when the estimate does not accurately match the investment required.

This paper proposes that the total loop *Investment Amount* be determined from the LEC's financials. Since the loop investments on the LEC's financials have often been made over a period of 25 years or more, it would be necessary to adjust the amount from the financials for inflation using an established index such as the Consumer Price Index or the Producer Price Index or a Telephone Plant Index.<sup>1</sup> Using this method, the average age of the total loop investment could be determined from the LEC's Continuing Property Records (CPRs) or by comparing a company's accumulated depreciation to its gross investment of the local loop plant.

### **3.2 Step 2: Determine the *Future Allowable Investment***

It is our belief that LECs should be allowed to replace plant that has reached the end of its Economic Life. To estimate the amount of loop investment that has reached the end of its Economic Life, the ratio of accumulated depreciation to gross plant for local loop investment from a company's financial records would be multiplied by the *Investment Amount* determined in Step 1. This result is the *Future Allowable Investment*. Since the accumulated depreciation and gross plant amounts change as facilities are added, depreciated, or retired, the ratio would be updated annually. The *Future Allowable Investment* is the amount of future loop plant investment that would qualify for Universal Service funding. A company may choose to invest more than the *Future Allowable Investment*, but any amount above the *Future Allowable Investment* (except for greenfield areas) would not be subject to Universal Service recovery in that year. If the loop investment of a LEC exceeds the *Future Allowable Investment*, the excess amount can be carried forward (rolled over) and may be included in (added to) the next year's calculation of *Future Allowable Investment*. Any rolled over amounts must be sub-accounted, so that it is not included in subsequent year's determination of *Future Allowable Investment*. However, this excess amount can be reduced in future years (and included in the plant in service) by the amount that the investment in any year is less than the *Allowed Investment* for that year. USF can only be recovered on the plant in service and not on these excess amounts until it has moved into the plant in service account by under-investing in future years.

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<sup>1</sup> Such an index is available from AUS Consultants, 275 Grandview Ave, Suite 100, Camp Hill, PA 17011



Currently, there is no standard for depreciation rates among companies. To ensure equal treatment for all companies, the FCC must establish standardized depreciation rates for loop plant in Category 1, Category 2, Category 4.11 and Category 4.13. On its website, the FCC has a document titled, "Depreciation Ranges Adopted in CC Docket No. 98-137 – December 17, 1999" that provides a listing of projected life ranges in years for the various asset categories, which defines a range of acceptable asset lives, which could be the basis for the standardized depreciation rates. To ensure that the universal service funds are being used to replace aging plant and a company is not investing in areas where the plant has not reached the end of its life, we propose that the existing ETC process be modified. The state utility commissions could ensure that USF funds are properly used for the advancement of broadband and investing in the areas where it is most needed. Broadband data could be collected for the construction area to ensure progress in broadband development (penetration or speed) is able to be calculated and measured for the construction area. Allowable time should be considered when monitoring time sensitive elements such as penetration or adoption. It seems logical that this tracking and monitoring of broadband and USF funds should be added to a state's ETC requirements.

The accuracy of this method is dependent upon the accuracy of the investment and depreciation amounts of loop plant in the company financials. Nevertheless, calculating the ratio of accumulated depreciation to total loop investment has the effect of cancelation of errors. For example, a company that has not properly retired equipment would include old equipment in both the total investment and accumulated depreciation amounts; but the ratio mitigates the error. Audits could also be used to ensure reliability of the reported information.

### **3.3 Step 3: Spread *Future Allowable Investment* over Investment Period**

Allowing companies to invest the entire *Future Allowable Investment* from Step 2 over a short period of time for purposes of USF recovery may put too much demand on the Universal Service fund; therefore, a method is needed to spread the *Future Allowable Investment* over a specified period of time. We propose that a LEC be allowed to replace its loop plant that has reached the end of its Economic Life over a 5-year period. This timeframe is consistent with many companies' construction planning, as well as the Rural Utilities Service loan requirements. Thus, a LEC would be allowed to invest up to 20% of its *Investment Amount* from Step 1 in any given year for purposes of USF recovery, but cannot exceed the *Future Allowable Investment* from Step 2.

As previously stated, if a company chooses to invest more than the *Future Allowable Investment* amount, it will be able to carry the excess amount forward (roll over) to subsequent years. This amount

will be added to the company's *Investment Amount* that would be eligible for support that year, unless the amount is greater than the *Future Allowable Investment*. The rollover amount should be depreciated, as with any asset, each year it is rolled over.

Consideration should also be given to small companies' investment cycles. It is inefficient to require a small company with only a small plant investment to stretch a small project over 5 or more years. Contractors' could gain efficiencies and have a lower bid if the project were large enough to gain some economies of scale. We propose that any company that has a total loop *Investment Amount* (from Step 1) of less than \$4,000,000 should be allowed to invest the entire *Future Allowable Investment* in a single year. In order for the fund to anticipate this additional investment amount, the company must notify USAC and/or NECA of their intention prior to the investment. This one-time investment exception would be accounted for and booked as a normal investment. No rollover process for this type of investment exception is required.

Even if a company has rebuilt its plant, there are normal maintenance and route upgrades that need to be done. Examples of such situations include the following:

- Flooding washes out cable
- A vehicle hits a pedestal
- A road is moved which impacts existing cable
- Lightning strikes the cable
- Rodents destroy cable

In these cases, loop plant must be repaired or replaced. Therefore, a company should be allowed to invest up to 5% of its current total loop investment per year for normal maintenance and routine upgrades. This amount would be in addition to any *Future Allowable Investment*, rollover or small company exception, or any greenfield builds.

## 4 Concluding Remarks

In summary, on a going forward basis if a company does not exceed its Allowable Investment, the company should be allowed to invest up to 20% of its total *Investment Amount* (not to exceed the *Future Allowable Investment*) plus 5% of its total loop investment, in addition to any required greenfield investments. The *Future Allowable Investment* would be re-calculated each year with the 20% amount to be calculated after the prior year's investment is figured in and the prior year's retirements is

removed. This method for determining allowed future investment in loop plant that qualify for Universal Service funding is simple, easy to implement, and we believe achieves the FCC's goals of a Universal Service fund that is sufficient, stable, and distributed fairly. This proposal also gives managers certainty and predictability as to what investments are recoverable going forward.

As stated earlier, it is difficult to estimate the investment required in all situations, therefore a simple FCC safety valve waiver process must be in place. This safety valve waiver process must be streamlined, since delays would slow investment and thus delay broadband deployment. In addition, there could be instances when a company may have relatively new plant that is not capable of meeting the FCC's broadband speed requirement. This situation may result from that the purchase of equipment or plant that cannot be upgraded to meet future customer demands or equipment made by vendors that have gone out of business, which requires that it be replaced before being fully depreciated. No matter the cause, these companies will have a low ratio of accumulated depreciation to gross plant, which under the process outlined above would not be able to invest sufficiently to meet the FCC's broadband speed requirements. A waiver or categorical exemption in these instances is appropriate and should be granted by the FCC in an expedited manner.

Sincerely,

A handwritten signature in black ink, appearing to read "Larry Thompson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Larry Thompson, PE  
Chief Executive Officer  
Vantage Point Solutions

## Appendix I – Example Capital Expense Determination

Example 1: Company 1 financials show:

- \$87.6M Total Loop Plant Investment (Category 1, Category 2, Category 4.11 and Category 4.13)
- \$55.2M Loop Plant Accumulated Depreciation

**Step 1:** Estimate Total Loop Plant Investment Amount

Total investment determined to be: \$100M

- Calculated using the Consumer Price Index, or other index, to allow for Inflation

**Step 2:** Determine Future Allowable Investment Amount

Depreciated Percent:  $\$55.2M/\$87.6M = 0.63$

Future Allowable Investment =  $\$100M * 0.63 = \$63M$  that is Support Eligible

**Step 3:** Spread Future Allowable Investment Amount over Investment Period

Result:  $\$100M * 0.2 = \$20M$  can be invested this year (since it is less than \$63M from Step 2)

- The Steps 1 – 3 would be recalculated each year to allow for the fact that plant additions, retirements, etc., will cause the Support Eligible amount to change from year to year.
- If company invests an amount in excess of the Support Eligible Amount, the excess can be carried forward and may be included in the next year's calculation.

Example 2: Company 2 financials show:

- \$9M Total Loop Plant Investment
- \$3M Loop Plant Accumulated Depreciation

**Step 1:** Estimate Total Loop Plant Investment Amount

Total investment determined to be: \$12M

**Step 2:** Determine Future Allowable Investment Amount

Depreciated Percent:  $\$3M/\$9M = 0.33$

Future Allowable Investment =  $\$12M * 0.33 = \$3.96M$  that is Support Eligible

**Step 3:** Spread Future Allowable Investment Amount over Investment Period

Result:  $\$12M * 0.20 = \$2.4M$  can be invested this year (The company could choose to invest \$3M of the Support Eligible amount of \$3.96M using a portion of their 5% of total loop plant over 5 years investment amount)

## Joint Association Comments

### Appendix B

#### **Analysis of Projected Financial Impacts Associated with Near-Term Changes to USF Mechanisms Proposed by the Federal Communications Commission**

This Appendix documents the financial impacts likely to occur for rural rate-of-return local exchange carriers (“RLECs”) if the FCC adopts revisions to federal Universal Service Fund (“USF”) rules as proposed in its February 9, 2011 *Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking* (“NPRM”). These results are based on analyses of the regulated operations of the RLECs.

The scenarios analyzed related to the current USF program are:

1. Reduce reimbursement rates for the HCLS program from 65% and 75% to 55% and 65%;
2. Eliminate corporate operating expenses from HCLS, LSS, and ICLS;
3. Examine the combined effects of eliminating corporate operating expenses (scenario 2) and reducing HCLS reimbursement rates (scenario 1);
4. Combine LSS and HCLS into one mechanism – replace study area loop cost with study area loop and switch cost;
5. Effects of eliminating LSS on interstate Local Switching Rate and Local Service Rates;
6. Impact of eliminating Safety Net Adjustment; and
7. Impact of proposed \$3,000/line Annual Cap on high-cost support.

Scenarios 1-5 use data gathered by NECA from special data requests, NECA pool settlement data, and USAC data. Scenarios 6-7 are based on USAC data for all rate-of-return carriers.

Four additional scenarios were prepared to analyze the effects on local service rates of reducing some or all ICC rates to lower levels if the resulting ICC revenue shortfalls are not recovered from a new support mechanism. The scenarios considered are:

- A. Lowering intrastate rates to interstate rate levels;
- B. Lowering intrastate and interstate access rates to a national average reciprocal compensation rate;
- C. Eliminating all ICC rates; and
- D. Lowering intrastate rates to interstate rate levels using a \$25 local rate benchmark with the shortfall picked up by a recovery mechanism.

Data for these scenarios come from a special data request and NECA pool settlement data.

We use summary statistics to measure the financial effects of proposed USF policy changes:<sup>1</sup>

1. Percent change in revenue;
2. Increase in local service rates per month;
3. Percent change in earnings;
4. Change in debt leverage (Total Debt/EBITDA), focusing on RLECs with debt leverage greater than 5;
5. Change in interest coverage (EBITDA/Interest), focusing on RLECs with interest coverage less than 2.25; and
6. Change in Times Interest Earned Ratio (TIER) focusing on RLECs with ratios falling below unity, making them ineligible for RUS loans.

For each measure, we arranged RLECs in order of effects caused by the proposed regulatory change. The ranks are from smallest number (usually most negative effect) to largest number (sometimes negative, sometimes positive effect). We present the results for the RLEC at the 50<sup>th</sup> percentile (Median), 10<sup>th</sup> percentile (10% of RLECs have smaller effects) and 90<sup>th</sup> percentile (10% of RLECs have larger effects). We also present the weighted mean effect, weighting done by RLEC access lines, to compute an average, overall financial effect.

The financial measure used for ICC reform is its effect on local service rates. In addition to average rate impacts, we add two additional categories, percent of subscribers whose local rates will increase by more than \$5 per month and a subset of subscribers whose bills will go up by more than \$30 per month.

**USF Reform, Scenario 1: Reduce reimbursement rates for the High Cost Loop Support (“HCLS”) program from 65% and 75%, to 55% and 65%.**

Table 1, Scenario 1 displays RLEC estimated losses or gains from reducing HCLS reimbursement rates. For this sample of RLECs, the average effect per subscriber is -0.5%, not revenue neutral as it would be for all USF participants. Absent another funding source, 10% of RLECs will have to increase local service rates by at least \$7.63 per month<sup>2</sup>, while 10% of RLECs will reduce rates by \$1.56 or more per month. The shift in funding raises the earnings of the top 10% “winners” by 1% or more, while reducing the bottom 10% “losers” by 1% or more. Without a new revenue stream, these RLECs will see their average debt leverage (total debt/EBITDA) increase from 2.65 to 2.87. The percent of study areas with debt leverage ratios above 5 rises from 23.2% to 23.7% (Table 2). The percent of RLECs with interest coverage (EBITDA/interest) of less than 2.25 rises from 7.6% to 7.9% (Table 3). The percent of RLECs

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<sup>1</sup> These measures were requested by analysts appointed by the Joint Board to analyze the financial effects of USF and ICC regulatory reform. The thresholds are from those selected by the analysts.

<sup>2</sup> Some subscribers experiencing rate increases could see increases significantly higher than this, with as many as 6% of those subscribers experiencing rate increases of \$10 or more.

falling below a value of “1” for TIER ((net income +interest)/interest) increases from 25.3% to 28.6% (Table 4).

### **USF Reform, Scenario 2: Eliminate corporate operating expenses from HCL, LSS, and ICLS.**

Table 1, Scenario 2 displays RLEC estimated losses from eliminating corporate operating expense recovery from HCLS, LSS, and ICLS. It produces an average 4.5% loss in revenue. As is typical with averages, they belie the range of effects across RLECs. Ten percent will experience a 14% or higher drop in revenue if this proposal goes into effect. A 14% or higher drop in revenue translates into 10% of RLECs having to raise local service rates by \$27.35 or more per month. If no alternative source of revenue is available to make up the shortfall, 10% will see their overall earnings (rate-of-return) drop by 8% or more. Without a new revenue stream, these companies will see their average debt leverage increase from 2.65 to 3.11. The percent of study areas with debt leverage ratios above 5 rises from 23.2% to 27.1% (Table 2). The percent of RLECs with interest coverage of less than 2.25 rises from 7.6% to 16.7% (Table 3). The percent of RLECs falling below a value of “1” for TIER increases from 25.3% to 44.0% (Table 4).

### **USF Reform, Scenario 3: Combined effects of eliminating corporate operating expenses (Scenario 2) and reducing HCLS reimbursement rates (Scenario 1).**

Table 1, Scenario 3 displays the combined effects of eliminating corporate operating expenses and reducing HCLS reimbursement rates. The combined effect produces an average 5.2% loss in revenue. Ten percent of RLECs will experience a 15% or higher drop in revenue if this proposal goes into effect. A 15% or higher drop in revenue translates into 10% of RLECs having to raise local service rates by \$33.61 or more per month. If no source of alternative revenue is available to make up the shortfall, 10% of RLECs will see their overall earnings (rate-of-return) drop by 8% or more. Without a new revenue stream, these RLECs will see their average debt leverage increase from 2.65 to 3.03. The percent of study areas with debt leverage ratios above 5 rises from 23.2% to 28.8% (Table 2). The percent of RLECs with interest coverage of less than 2.25 rises from 7.6% to 18.0% (Table 3). The percent of RLECs falling below a value of “1” for TIER increases from 25.3% to 47.1% (Table 4)

### **USF Reform, Scenario 4: Combine LSS and HCL support into one support mechanism.**

Table 1, Scenario 4 displays RLEC estimated losses or gains from combining LSS and HCL support by replacing study area loop cost with study area loop and switch cost. For this sample of RLECs, the average effect is only 0.2%, almost revenue neutral on average, as one would expect for all USF participants. Absent an alternative revenue source, 10% of RLECs will have to increase local service rates by at least \$4.43 per month, while 10% of RLECs will reduce rates by \$6.47 or more per month. The shift in funding raises the earnings of the top 10% “winners” by 3% or more while reducing the bottom 10% “losers” by 3% or more. Without a new revenue

stream, these RLECs will see their average debt leverage increase from 2.65 to 2.80. The percent of study areas with debt leverage ratios above 5 decreases from 23.2% to 21.5% (Table 2). The percent of RLECs with interest coverage of less than 2.25 rises from 7.6% to 8.1% (Table 3). The percent of RLECs falling below a value of “1” for TIER increases from 25.3% to 27.1% (Table 4).

### **Scenario 5: Effect of eliminating LSS on the interstate Local Switching Rate and Local Service Rates.**

NECA’s 2010 Annual filing shows local switching support generates \$222 million to offset the pool’s \$398 million local switching revenue requirement.<sup>3</sup> If LSS support were eliminated, local switching rates would increase from \$.019 to \$.044, representing a 127% increase in the local switching rate (Table 5a).

If the elimination of LSS falls on customers to pick up the shortfall, the average local service bill would increase by \$4.37 per month. In the most affected study areas (90<sup>th</sup> percentile and above), monthly rates would increase by \$16.91 per month or more (Table 5b).

### **Scenario 6: Effect of eliminating Safety Net Adjustment.**

Table 6 shows that, on average, RLECs receiving Safety Net Adjustment support would lose \$3.34 per line per month if SNA were eliminated. The loss by RLEC ranges from \$.01 per line per month to \$14.33 per line per month.

### **Scenario 7: Impact of proposed \$3,000/line annual cap on high cost support.**

Table 7 shows the loss in support per month for non-tribal RLECs located in the contiguous United States receiving more than \$3,000 in annual support per line. The loss ranges from \$1,200 per month per line to \$9.24 per month per line. The weighted average loss per line per month is \$104.92.

### **ICC Scenarios A, B, and C: Reducing ICC Rates**

Table 8 displays the financial effects of the three ICC reform scenarios. Reducing intrastate access rates to interstate levels raises an average subscriber’s local service rate by \$5.98 per month. Ten percent of RLECs will have to raise their monthly rates by \$16.23 or more to cover the revenue shortfall. Forty-six percent of subscribers will see their monthly bill increase by \$5.00 or more, and 0.7% of subscribers will see their bill increase by more than \$30 per month.

Reducing intra- and interstate access rates to a nationally-averaged reciprocal compensation rate level raises an average subscriber’s local service rate by \$11.77 per month. Ten percent of RLECs will have to raise their monthly rates by \$25.89 or more to cover the revenue shortfall.

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<sup>3</sup> Excluding 800/888 database queries.



Eighty percent of subscribers will see their monthly bill increase by \$5.00 or more, and 2.6% of subscribers will see their bill increase by more than \$30 per month.

Eliminating all intercarrier compensation rates raises an average subscriber's local service rate by \$16.47 per month. Ten percent of RLECs will have to raise their monthly rates by \$31.17 or more to cover the revenue shortfall. Ninety-eight percent of subscribers will see their monthly bill increase by \$5.00 or more, and 7.2% of subscribers will see their bill increase by more than \$30 per month.

**ICC Scenario D: Lowering intrastate to interstate access rates, and applying a \$25 per line per month local rate benchmark to calculate a residual funding mechanism.**

Table 9 displays these effects by state and in total for RLECs. Reducing intrastate to interstate access rates produces a \$367.4 million shortfall before instituting the \$25 per month residential subscriber service rate benchmark. The \$25 benchmark reduces the shortfall to \$215 million. The per line, per month shortfall ranges from \$0 in Nevada to \$16 in Alaska.

**Table 1: USF Restructuring**

	90th	Median	10th	Weighted Mean
<b>Scenario 1: Expense Adj @ NPRM proposed 55% and 65%</b>				
Percent Change in Total Study Area Revenue <sup>1</sup>	2.00%	0.00%	-3.00%	-0.53%
\$ Increase in Local Rates per month <sup>1</sup>	\$7.63	\$0.00	-\$1.56	\$0.60
Percent Change in Earnings <sup>2</sup>	1.00%	0.00%	-1.00%	-0.09%
<b>Scenario 2: Eliminate Corp Ops from HCL, LSS, and ICLS</b>				
Percent Change in Total Study Area Revenue <sup>1</sup>	-2.00%	-6.00%	-14.00%	-4.49%
\$ Increase in Local Rates per month <sup>1</sup>	\$27.35	\$5.88	\$1.63	\$5.08
Percent Change in Earnings <sup>2</sup>	-1.00%	-3.00%	-8.00%	-2.41%
<b>Scenario 3: Eliminate Corp Ops from LSS, ICLS and HCL and modify HCL thresholds (Scenario 1 + Scenario 2)</b>				
Percent Change in Total Study Area Revenue <sup>1</sup>	-1.00%	-6.00%	-15.00%	-5.17%
\$ Increase in Local Rates per month <sup>1</sup>	\$33.61	\$5.86	\$1.32	\$5.85
Percent Change in Earnings <sup>2</sup>	-1.00%	-3.00%	-8.00%	-2.47%
<b>Scenario 4: Combine LSS and HCL - Total Combined loop and switch cost</b>				
Percent Change in Total Study Area Revenue <sup>1</sup>	5.00%	0.00%	-4.00%	0.16%
\$ Increase in Local Rates per month <sup>1</sup>	\$4.43	\$0.47	-\$6.47	-\$0.19
Percent Change in Earnings <sup>2</sup>	3.00%	0.00%	-3.00%	-0.03%

Notes:

<sup>1</sup> Responses to Broadband Reform Data Request (BRDR July 2010) from 702 study areas used. Interstate revenues and minutes come from 2009 NECA Settlements and BRDR when necessary. Intrastate revenues and minutes come from BRDR and CABS.

<sup>2</sup> Responses from 693 study areas used to calculate earnings. Change in earnings calculated as the difference in the RoR before and after the policy change.

**Table 2: Debt Leverage Analysis<sup>1</sup>**

Scenario	Current Debt Leverage				New Debt Leverage				Current Debt Leverage > 5		New Debt Leverage > 5	
	90th	Median	10th	Weighted Mean	90th	Median	10th	Weighted Mean	% Subscribers	% Study Areas	% Subscribers	% Study Areas
1. Expense Adj @ NPRM proposed 55% and 65%	7.35	2.76	0.83	2.65	7.96	2.85	0.83	2.87	8.82%	23.16%	9.22%	23.73%
2. Eliminate Corp Ops from HCL, LSS, and ICLS	7.35	2.76	0.83	2.65	10.29	3.08	0.86	3.11	8.82%	23.16%	12.19%	27.12%
3. Eliminate Corp Ops from LSS, ICLS and HCL and modify HCL thresholds	7.35	2.76	0.83	2.65	11.11	3.05	0.86	3.03	8.82%	23.16%	12.54%	28.81%
4. Combine LSS and HCL - Total Combined loop and switch cost	7.35	2.76	0.83	2.65	7.46	2.76	0.81	2.80	8.82%	23.16%	8.49%	21.47%

Notes:

<sup>1</sup> Used responses to Broadband Reform Data Request (BRDR July 2010) from 177 study areas providing debt. Interstate revenues and minutes come from 2009 NECA Settlements and BRDR when necessary. Intrastate revenues and minutes come from BRDR and CABS. Debt leverage defined as Total Debt / EBITDA in 2009.

**Table 3: Interest Coverage Analysis<sup>1</sup>**

Scenario	Current Interest Coverage				New Interest Coverage				Current Interest Coverage < 2.25		New Interest Coverage < 2.25	
	90th	Median	10th	Weighted Mean	90th	Median	10th	Weighted Mean	% Subscribers	% Study Areas	% Subscribers	% Study Areas
1. Expense Adj @ NPRM proposed 55% and 65%	35.32	7.82	2.83	8.42	35.36	7.65	2.70	8.24	2.27%	7.59%	2.11%	7.85%
2. Eliminate Corp Ops from HCL, LSS, and ICLS	35.32	7.82	2.83	8.42	29.07	6.4	0.7	7.55	2.27%	7.59%	5.27%	16.71%
3. Eliminate Corp Ops from LSS, ICLS and HCL and modify HCL thresholds	35.32	7.82	2.83	8.42	29.39	6.17	0.64	7.34	2.27%	7.59%	5.52%	17.97%
4. Combine LSS and HCL - Total Combined loop and switch cost	35.32	7.82	2.83	8.42	35.19	7.83	2.88	8.46	2.27%	7.59%	2.75%	8.10%

Notes:

<sup>1</sup> Used responses to Broadband Reform Data Request (BRDR July 2010) from 395 study areas providing positive interest expenses. Interstate revenues and minutes come from 2009 NECA Settlements and BRDR when necessary. Intrastate revenues and minutes come from BRDR and CABS. Interest coverage defined as (EBITDA)/ interest in 2009.

**Table 4: TIER Analysis<sup>1</sup>**

Scenario	Current TIER				New TIER				Current TIER < 1		New TIER < 1	
	90th	Median	10th	Weighted Mean	90th	Median	10th	Weighted Mean	% Subscribers	% Study Areas	% Subscribers	% Study Areas
1. Expense Adj @ NPRM proposed 55% and 65%	10.29	2.4	-1.74	2.72	11.38	2.07	-1.85	2.57	16.00%	25.32%	17.71%	28.61%
2. Eliminate Corp Ops from HCL, LSS, and ICLS	10.29	2.4	-1.74	2.72	7.54	1.33	-5.17	1.97	16.00%	25.32%	25.62%	44.05%
3. Eliminate Corp Ops from LSS, ICLS and HCL and modify HCL thresholds	10.29	2.4	-1.74	2.72	8.03	1.19	-5.30	1.79	16.00%	25.32%	27.50%	47.09%
4. Combine LSS and HCL - Total Combined loop and switch cost	10.29	2.4	-1.74	2.72	11.74	2.41	-1.95	2.73	16.00%	25.32%	18.87%	27.09%

Notes:

<sup>1</sup> Used responses to Broadband Reform Data Request (BRDR July 2010) from 395 study areas providing positive interest expenses. Interstate revenues and minutes come from 2009 NECA Settlements and BRDR when necessary. Intrastate revenues and minutes come from BRDR and CABS. TIER defined as (net income + interest)/ interest in 2009.

**Table 5a: Eliminate LSS**

Line	Item	Value	Source
1	Local Switching Revenue Requirement After LSS	\$175,039,813	2010 Annual Filing, Volume 5
2	Local Switching Minutes	9,023,806,972	2010 Annual Filing, Volume 5
3	Current Local Switching Rate	\$0.019398	Line 1 / Line 2
4	Local Switching Support	\$222,540,768	2010 Annual Filing, Volume 5
5	Local Switching Revenue Requirement & LSS	\$397,580,581	Line 1 + Line 4
6	Rate Required to Meet Revenue Requirement without LSS	\$0.044059	Line 5 / Line 2
7	Required Increase in LS Rate	127%	100 * (Line 6 / Line 3) - 1

**Table 5b: Eliminate LSS <sup>1</sup>**

Scenario:	\$ Increase in Local Rates per month			
	90th	Median	10th	Weighted Mean
Eliminate LSS	\$16.91	\$5.77	\$1.98	\$4.37

Notes:

<sup>1</sup> Used projection data for 2010 Traffic Sensitive (TS) pool members from 2010 Annual Filing (N = 1091).**Table 6: 2011 Safety Net Summary**

Carrier Type	Current Recipients	2011 Safety Net Support	Supported Lines	Average Annual Support per Line	Average Monthly Support per Line Notes 2&3
Rural Rate of Return	360	\$61,218,579	1,525,893	\$40.12	\$3.34

Source: USAC HC-06 2Q2011

Notes

- 1 HC-06 also lists an additional 52 CETC Study Areas with support totaling \$2.875 M that are not eligible for SNA.
- 2 Range in support per line attributable to SNA for price cap recipients is \$0.56 per line per month to \$11.10 per line per month
- 3 Range in support per line attributable to SNA for rate of return recipients is \$0.01 per line per month to \$14.33 per line per month

**Table 7: Impact of Proposed \$3,000 Annual Cap per Line on Monthly Support per Line**

State	SAC	Study Area Name	Rural	Working Loops	Annualized High Cost Support	Annual Support per Line	Annual Support @ \$3000	Monthly Impact per Line
<i>Contiguous 48 Non-Tribal Lands Companies</i>								
WA	520581	BEAVER CREEK TELEPHONE COMPANY	R	27	\$469,992.00	\$17,407.11	\$81,000.00	(1200.59)
TX	442073	BORDER TO BORDER	R	91	\$1,557,492.00	\$17,115.30	\$273,000.00	(1176.27)
WA	520580	WESTGATE COMMUNICATIONS LLC D/B/A WEAATEL	R	19	\$314,700.00	\$16,563.16	\$57,000.00	(1130.26)
MI	310542	ALLBAND COMMUNICATIONS COOPERATIVE	R	134	\$1,337,424.00	\$9,980.78	\$402,000.00	(581.73)
AZ	452191	ACCIPITER COMM.	R	353	\$3,359,400.00	\$9,516.71	\$1,059,000.00	(543.06)
CO	462195	SOUTH PARK TEL. CO.	R	173	\$1,101,732.00	\$6,368.39	\$519,000.00	(280.70)
ND	382247	NEMONT TEL COOP - ND	R	214	\$1,358,364.00	\$6,347.50	\$642,000.00	(278.96)
TX	442066	DELL TEL. CO-OP - TX	R	796	\$4,893,324.00	\$6,147.39	\$2,388,000.00	(262.28)
OR	532392	PINE TEL SYSTEM INC.	R	955	\$4,197,828.00	\$4,395.63	\$2,865,000.00	(116.30)
CO	462178	AGATE MUTUAL TEL CO	R	115	\$460,488.00	\$4,004.24	\$345,000.00	(83.69)
NV	552284	BEEHIVE TEL CO - NV	R	129	\$497,088.00	\$3,853.40	\$387,000.00	(71.12)
OR	532388	NORTH STATE TEL CO.	R	487	\$1,805,460.00	\$3,707.31	\$1,461,000.00	(58.94)
UT	502284	BEEHIVE TEL CO - UT	R	919	\$3,258,156.00	\$3,545.33	\$2,757,000.00	(45.44)
TX	442039	BIG BEND TEL CO INC	R	5,598	\$19,729,920.00	\$3,524.46	\$16,794,000.00	(43.70)
KS	411809	MUTUAL TEL CO	R	450	\$1,485,132.00	\$3,300.29	\$1,350,000.00	(25.02)
KS	411791	LA HARPE TEL CO INC	R	337	\$1,085,388.00	\$3,220.74	\$1,011,000.00	(18.39)
WA	522442	ST JOHN TEL CO	R	601	\$1,927,104.00	\$3,206.50	\$1,803,000.00	(17.21)
CA	542346	PINNACLES TEL CO	R	257	\$799,500.00	\$3,110.89	\$771,000.00	(9.24)
				11,655	\$49,638,492.00		\$34,965,000.00	(\$104.92)

Source: 2Q2011 USAC Report Appendices HC-01 and HC-05

**Table 8: Reduction in ICC Rates**<sup>1</sup>

Scenario:	\$ Increase in Local Rates per month				% > \$5.00		% > \$30.00	
	90th	Median	10th	Weighted Mean	Subscribers	Study Areas	Subscribers	Study Areas
1. Intrastate To Interstate	\$16.23	\$4.78	\$0.00	\$5.98	46.52%	48.15%	0.70%	2.28%
2. All To Reciprocal Compensation	\$25.89	\$11.15	\$4.52	\$11.77	80.61%	87.04%	2.64%	5.56%
3. Bill and Keep	\$31.17	\$15.62	\$8.43	\$16.47	98.51%	98.72%	7.02%	11.68%

Notes:

<sup>1</sup> Based on a sample of 702 study areas responding to Broadband Reform Data Request (BRDR July 2010). Interstate revenues and minutes come from 2009 NECA Settlements and BRDR when necessary. Intrastate revenues and minutes come from BRDR and CABS.

**Table 9: Rural Association Inter-carrier Model for Common Line 2010 Pool Members Using 2009 Data**  
**State Level Disaggregation**  
**Using Company Specific Rates**  
**(No SLC Increases and Local Rate Benchmark = \$25)**

STATE	Interstate Rev	Interstate Mou	Interstate Rate/Mou	Intrastate Rev	Intrastate Mou	Intrastate Rate/Mou	Access Rebalancing	Additional Rev Produced by \$25 Local Rate Benchmark	Restructure Mechanism (RM)	RM/Line per Month	Total Access Lines	% of Rural Pool Participant Lines
AK	\$8,467,974	336,435,404	\$0.0252	\$30,107,438	280,528,866	\$0.1073	\$21,440,400	\$901,148	\$21,054,969	\$15.99	109,704	44%
AL	\$6,017,528	296,581,705	\$0.0203	\$12,631,559	248,000,668	\$0.0509	\$7,471,732	\$1,719,652	\$5,815,536	\$4.87	99,489	80%
AR	\$4,182,156	181,840,415	\$0.0230	\$14,081,025	113,581,537	\$0.1240	\$11,424,539	\$4,371,728	\$7,511,620	\$8.67	72,225	64%
AZ	\$3,063,759	84,576,595	\$0.0362	\$7,095,250	71,666,052	\$0.0990	\$4,099,353	\$1,842,081	\$2,657,712	\$6.15	36,030	60%
CA	\$7,562,646	265,806,823	\$0.0285	\$12,590,113	593,724,657	\$0.0212	\$1,459,664	\$1,427,361	\$1,250,937	\$0.72	144,093	45%
CO	\$1,935,522	81,165,528	\$0.0238	\$2,533,899	36,168,846	\$0.0701	\$1,609,748	\$461,214	\$1,217,607	\$3.03	33,533	85%
FL	\$3,776,167	305,173,493	\$0.0124	\$7,894,299	148,213,187	\$0.0533	\$5,647,726	\$4,787,711	\$3,496,517	\$3.86	75,549	77%
GA	\$11,429,269	480,641,179	\$0.0238	\$26,622,865	430,748,906	\$0.0618	\$15,926,502	\$8,214,843	\$8,327,968	\$3.41	203,794	63%
IA	\$18,357,714	494,459,625	\$0.0371	\$26,275,966	435,229,134	\$0.0604	\$12,549,589	\$10,842,076	\$4,428,483	\$1.82	203,218	81%
ID	\$5,205,364	107,027,990	\$0.0486	\$2,357,682	30,495,881	\$0.0773	\$1,210,783	\$520,005	\$690,778	\$1.64	35,091	80%
IL	\$4,568,740	236,430,721	\$0.0193	\$13,363,464	214,250,581	\$0.0624	\$7,375,454	\$340,288	\$7,035,166	\$7.12	82,320	60%
IN	\$7,561,963	328,517,298	\$0.0230	\$10,595,523	347,792,602	\$0.0305	\$2,366,149	\$3,015,220	\$2,199,838	\$1.46	125,241	85%
KS	\$8,470,907	286,773,452	\$0.0295	\$7,841,740	279,485,703	\$0.0281	\$690,268	\$2,229,653	\$199,076	\$0.15	109,586	96%
KY	\$7,894,385	411,558,946	\$0.0192	\$30,067,277	429,109,868	\$0.0701	\$20,878,008	\$9,864,726	\$11,780,972	\$6.56	149,720	76%
LA	\$2,134,639	139,581,744	\$0.0153	\$4,978,899	236,721,481	\$0.0210	\$2,822,133	\$2,695,012	\$1,305,048	\$1.62	67,098	75%
ME	\$4,240,441	165,474,131	\$0.0256	\$3,806,060	152,449,672	\$0.0250	\$1,003,533	\$9,577	\$1,003,533	\$1.11	75,131	49%
MI	\$5,009,549	164,719,476	\$0.0304	\$11,649,124	150,124,395	\$0.0776	\$7,712,076	\$133,968	\$7,617,090	\$8.22	77,179	70%
MN	\$17,378,239	576,934,885	\$0.0301	\$43,979,019	624,174,103	\$0.0705	\$24,242,674	\$14,749,429	\$12,542,464	\$3.37	309,976	63%
MO	\$5,558,710	236,251,300	\$0.0235	\$26,588,964	290,772,521	\$0.0914	\$19,224,563	\$10,032,416	\$10,749,850	\$8.52	105,140	89%
MS	\$2,600,280	107,655,910	\$0.0242	\$14,131,009	143,223,640	\$0.0987	\$10,288,424	\$1,915,883	\$8,402,661	\$14.94	46,870	61%
MT	\$11,255,824	289,799,182	\$0.0388	\$12,669,997	150,803,207	\$0.0840	\$6,627,941	\$1,270,041	\$5,357,900	\$4.81	92,798	96%
NC	\$10,925,390	610,990,225	\$0.0179	\$17,994,168	389,629,061	\$0.0462	\$10,933,774	\$14,868,153	\$1,954,347	\$0.60	273,459	76%
ND	\$13,050,668	349,507,325	\$0.0373	\$22,577,762	232,419,396	\$0.0971	\$13,553,889	\$3,368,656	\$10,253,622	\$5.77	148,081	96%
NE	\$4,941,104	143,362,697	\$0.0345	\$13,380,651	133,418,807	\$0.1003	\$8,807,557	\$541,354	\$8,558,204	\$11.49	62,094	83%
NM	\$5,092,713	101,378,938	\$0.0502	\$1,955,327	60,279,246	\$0.0324	\$27,991	\$641,342	\$7,670	\$0.02	35,607	79%
NV	\$3,965,513	94,602,655	\$0.0419	\$1,780,328	42,427,273	\$0.0420	\$918,051	\$1,817,767	\$0	\$0.00	29,778	89%
NY	\$6,169,863	291,617,328	\$0.0212	\$16,686,913	343,716,095	\$0.0485	\$9,908,127	\$7,489,289	\$3,294,413	\$2.06	133,346	42%
OH	\$3,188,882	144,531,491	\$0.0221	\$12,221,266	206,084,109	\$0.0593	\$8,202,695	\$985,655	\$7,319,020	\$7.11	85,790	45%
OK	\$11,674,611	421,467,617	\$0.0277	\$22,719,462	508,754,846	\$0.0447	\$7,567,143	\$7,270,284	\$3,485,339	\$1.72	168,446	98%
OR	\$3,228,157	150,834,254	\$0.0214	\$7,009,757	77,997,969	\$0.0899	\$5,375,080	\$1,736,714	\$3,638,366	\$4.46	67,981	64%
SC	\$21,079,156	1,195,851,316	\$0.0176	\$20,817,931	490,806,114	\$0.0424	\$11,357,823	\$10,684,727	\$5,988,134	\$1.27	392,283	49%
SD	\$13,754,261	300,205,973	\$0.0458	\$29,788,498	238,673,273	\$0.1248	\$17,210,139	\$4,751,139	\$12,487,807	\$8.01	129,880	79%
TN	\$10,476,095	679,729,536	\$0.0154	\$22,255,900	400,070,036	\$0.0556	\$16,218,831	\$16,159,214	\$4,033,559	\$1.19	281,356	91%
TX	\$11,888,085	339,429,537	\$0.0350	\$29,180,265	545,330,825	\$0.0535	\$9,205,641	\$20,296,111	\$2,001,984	\$0.74	225,985	63%
UT	\$7,822,766	129,505,803	\$0.0604	\$6,541,369	107,366,756	\$0.0609	\$1,421,541	\$2,357,103	\$86,817	\$0.11	66,234	67%
VT	\$3,698,501	169,281,720	\$0.0218	\$4,128,288	61,745,296	\$0.0669	\$2,563,878	\$2,477,558	\$443,259	\$0.70	52,703	55%
WA	\$3,844,340	165,201,655	\$0.0233	\$9,824,075	98,352,350	\$0.0999	\$7,482,171	\$3,673,874	\$3,808,297	\$4.46	71,179	64%
WI	\$16,900,421	744,380,625	\$0.0227	\$26,929,444	492,234,377	\$0.0547	\$15,775,790	\$10,253,032	\$7,245,353	\$2.05	294,396	78%
WY	\$3,308,465	110,391,124	\$0.0300	\$1,939,677	42,020,502	\$0.0462	\$655,390	\$0	\$655,390	\$1.62	33,700	82%
Other	\$37,934,506	1,587,928,359	\$0.0239	\$70,738,805	1,525,692,273	\$0.0464	\$34,172,200	\$23,893,896	\$15,065,065	\$1.96	641,694	10%
Total	\$339,615,275	13,307,603,980	\$0.0255	\$660,331,058	11,404,284,107	\$0.0579	\$367,428,971	\$214,609,902	\$214,972,373	\$3.29	5,447,775	64%

Footnotes

<sup>1</sup> Interstate revenues and minutes for 2010 Common Line Pool members (N = 1140) come from 2009 NECA Settlements and Broadband Reform Data Request (BRDR July 2010) when necessary. Intrastate revenues and minutes come from BRDR and CABS. Responses from 745 companies representing 64% of the access lines were used and scaled to the pool using a scale factor based on access lines at the state level.

<sup>2</sup> MA, NH, PA, VA and WV are shown in Other, due to limited sample in the BRDR. These 5 states represent 10% of the total interstate minutes.

<sup>3</sup> American Samoa, Guam, Hawaii, New Jersey and Maryland are not in the report because BRDR did not collect data from those states/territories.

<sup>4</sup> At the company level, RM (Restructure Mechanism) is the difference between Access Rebalancing amount and \$25 Local Rate Benchmark amount when the difference is greater than zero. Access Rebalancing calculates the impact of setting intrastate rates equal to interstate rates. \$25 Local Rate Benchmark (includes current composite local residential, SLB, or MLB rate, current SLC cap, current intrastate SLC and state USF surcharge per line) calculates the additional revenue opportunity when total inclusive local rates are raised to \$25 per line.



## **Appendix C**

### **Current and Potential Future Carrier of Last Resort Responsibilities**

# Carrier of Last Resort (COLR) Obligations

## I. CURRENT OBLIGATIONS

### A. Federal ETC Requirements

- Voice grade access to the Public Switched Telephone Network (PSTN)
- Local usage
- Dual tone multi-frequency signaling or functional equivalent
- Single party service or functional equivalent
- Access to 911, E-911
- Access to operator services
- Access to IXC services
- Access to directory assistance (DA)
- Toll limitation for low-income consumers

### B. Local COLR Obligations (generally fall into five broad categories):

1. Duty to serve. A COLR must extend retail voice service to any potential customer on request, within its franchisee area, subject only to reasonable conditions, and in accord with reasonable quality standards.
2. Line extensions. A COLR must extend its lines into any unserved newly-built areas, subject to reimbursement for costs in some or all cases.
3. Exit barriers. A COLR must continue providing service until granted permission to exit.
4. Other retail benefits. A COLR may be required to provide certain additional economic and service benefits to specified customers and former customers.
5. Carrier-to-carrier duties. A COLR must provide certain interconnection and other wholesale services needed by other carriers.

### C. Various State COLR obligations:

- Access to (a) single party local exchange service, or (b) service that is equivalent, in all substantial respects, to single party local exchange service.
- Access to all interexchange carriers offering service in the customer's local exchange.
- Ability to place calls.
- Ability to receive free unlimited incoming calls.
- Free touch-tone dialing.
- Free unlimited access to 911/E-911.
- Access to local DA.

- Customer choice of flat-rate local service or measured-rate local service.
- Free provision of one directory listing per year.
- Free white pages telephone directory.
- Access to operator service.
- Voice grade connection to the PSTN.
- Free access to 800 or 800-like toll-free services.
- One-time free blocking for information services and one-time billing adjustments for changes incurred inadvertently, mistakenly, or that were unauthorized.
- Access to telephone relay services.
- Toll-free access to customer service for information about state lifeline, service activation, service termination, service repair, and bill inquiries.
- Toll-free access to customer service representatives fluent in the same language (English and non-English).
- Free access to toll-blocking service.
- Free access to toll-control service, but only if (i) the utility is capable of offering toll-control service, and (ii) the customer has no unpaid bill for toll service.
- Access to two residential telephone lines if a low-income household with a disabled person requires both lines to access state lifeline program.
- Free access to state Relay Service via the 711 abbreviated dialing code.
- Essential telecommunications services at affordable prices, including the following:
  - Single-party voice-grade service with:
    - Line quality capable of facsimile transmission.
    - Line quality capable of data transmission.
    - Dual-tone multi-frequency touchtone and rotary pulse dialing operability.
    - Access to emergency services numbers and 9-1-1 operability where requested by local authorities.
    - Equal access to interlata interexchange carriers subject to FCC orders and rules.
    - Equal access to intralata interexchange carriers pursuant to schedules, terms and conditions imposed by state commission orders and rules.
    - Single party revertive calling, if two or more pieces of customer premises equipment can be simultaneously active on the line or channel being used by the customer.
    - A reasonably adequate number of calls within a reasonably adequate local calling area as defined by the state commission.
    - Connectivity with all public toll, local, wireline and wireless networks, and with various Internet service providers.
    - Telecommunications relay service to facilitate communication between teletypewriter users and non-teletypewriter users.
    - Access to operator service.
    - Access to directory assistance.
    - Toll blocking, 900 and 976 number blocking and extended community calling blocking options.
    - Intercept and announcements for vacant, changed, suspended and disconnected numbers in oral and teletypewriter (TTY)-readable formats.
    - A directory listing with the option for non-listed and non-published service.

## II. POTENTIAL FUTURE COLR OBLIGATIONS OF ETC CAF RECIPIENTS

- Must be ETC designated pursuant to section 214.
- Advertise and offer broadband of defined speed and functionalities (“Broadband”).
  - Speeds and functionalities must be reasonably comparable to those provided in urban areas.
  - Speed and functionalities must be evaluated annually to ensure continuing reasonable comparability.
  - Functionalities may include standards regarding acceptable levels of packet loss and jitter.
- Advertise and offer voice service that offers the functional equivalent of all current Federal ETC Requirements for voice services as noted above (“Quality Voice”).
  - Quality Voice may be offered via VoIP or other “over the top” service, but only if that service is functionally equivalent to voice grade PSTN access.
- Offer Broadband and Quality Voice each on a stand-alone basis (in addition to any voluntary bundles).
- Must own or have long-term lease with respect to “last-mile” or equivalent facilities or spectrum used to deliver Broadband and Quality Voice.
- Must extend retail Broadband and Quality Voice service, as applicable, to potential customers on request within the designated service area, subject only to reasonable conditions and in accord with reasonable quality standards. [NOTE: Must be linked to adequate CAF funding to support installation of network and ongoing, affordable, quality delivery of service to each such customer.]
- Must extend network capable of delivering Broadband and Quality Voice services into any unserved newly built areas within the designated service area, subject to reimbursement for costs. [NOTE: Must be linked to adequate CAF funding to support installation of network.]
- Must comply with consumer protection standards for Broadband and Quality Voice services.
  - Truth-in-billing
  - Non-deceptive advertising
  - Pre-purchase disclosures
- Must prepare and submit periodic (e.g., semi-annual) reports on performance of COLR obligations to state regulators and FCC.
  - Should not be held accountable for failures on third-party networks that result in failures to meet service standards (e.g., delays on middle mile networks controlled by third parties that affect Broadband speeds, etc.).
  - Must submit to state jurisdiction for purposes of evaluating and addressing accountability – compliance with these COLR obligations.
- Must submit to state exit and mass migration rules, both for Broadband and Quality Voice services.

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the Associations' Comments was served this 18<sup>th</sup> day of April, 2011 by electronic filing and e-mail to the persons listed below.

By: /s/ Elizabeth R. Newson  
Elizabeth R. Newson

The following parties were served:

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