Before the
Federal Communications Commission
Washington, D.C. 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
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

PETITION FOR RECONSIDERATION AND CLARIFICATION

of the

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

December 29, 2011

TABLE OF CONTENTS

I. **THE COMMISSION SHOULD ADOPT A SUFFICIENT AND PREDICTABLE CONNECT AMERICA FUND MECHANISM *BEFORE* IMPOSING BROADBAND-RELATED PUBLIC INTEREST OBLIGATIONS ON RATE-OF-RETURN CARRIERS.** 2

II. **THE SUPPORT CUTS AND COST RECOVERY LIMITATIONS IN THE ORDER MUST BE RECONSIDERED OR CLARIFIED SO AS TO AVOID CONFLICTS WITH THE PUBLIC INTEREST OBLIGATIONS IMPOSED BY THE ORDER, THE GOALS OF THE REFORMS, AND THE NEW UNIVERSAL SERVICE PRINCIPLE ADOPTED BY THE COMMISSION.** 6

- A. **The Commission Should Reconsider the Sufficiency of its Budget for High-Cost Universal Service.** 6
- B. **The Commission Should Reconsider Several Aspects of its Caps on Capital and Operating Expenses** 9
- C. **The Commission Should Reconsider Or Modify Several Of The Other Capping Mechanisms Adopted In The Order.** 13
  1. **The Commission Should Determine Reasonably Comparable Rates on the Basis of Standard Deviations, Rather than Arithmetic Average.** 13
  2. **The Commission Should Reconsider Several Aspects of its Decision with Respect to the Elimination of Safety Net Additive Support.** 14
  3. **The Order's Adoption of a Per-Line Cap on High-Cost Support Imposes Substantial Damage on Small Companies with Little Aggregate Public Interest Benefit.** 16
  4. **The Commission Should Not Begin Phasing Out Support in Areas with Competitive Overlap Without Addressing Ongoing RLEC Obligations as COLRs and ILECs.** 18

III. **THE ORDER ESTABLISHES UNREASONABLY STRINGENT STANDARDS FOR OBTAINING WAIVERS OF THE SUPPORT REDUCTION RULES AND FOR REQUESTING ADDITIONAL CAF ICC SUPPORT.** 19

IV. **NEW RULES IMPOSING ANNUAL REPORTING REQUIREMENTS ON RLECs ARE UNDULY BURDENSOME AND SHOULD BE SUBSTANTIALLY REVISED.** 22

V. **THE COMMISSION MUST ESTABLISH CLEAR RULES GOVERNING THE RATE OF RETURN REPRESCRIPTION PROCESS BEFORE INITIATING A REPRESCRIPTION HEARING.** 26

- A. **The FCC Must First Adopt New Substantive Rules Governing the Represcription Process Before It Takes Evidence to Determine a Reasonable Rate-of-Return.** 26
- B. **The Abbreviated Informal Notice and Comment Procedures Described in the FNPRM Will Not Satisfy Section 205(a)'s "Hearing" Requirement.** 27

VI. RECONSIDERATION AND/OR CLARIFICATION IS REQUIRED REGARDING THE APPLICATION OF NEW INTERCARRIER COMPENSATION RULES ADOPTED IN THE ORDER. ... 29

A. The Commission Must Provide a Reasonable Opportunity for Rate-of-Return Carriers to Recover Interstate Costs Allocated to Switched Access Rate Elements. ... 29

B. Mechanics of CAF ICC Support Calculations. ... 31

1. Rate-of-Return Baseline Interstate Revenue Requirements Should Be Based on Actual Cost Studies Rather than Tariff Forecasts. ... 31

2. Inclusion of Tandem/Transit Costs in Reciprocal Compensation Calculations. ... 33

C. Identification of "Toll" VoIP Traffic. ... 33

D. Call Signaling Rules for VoIP Traffic. ... 35

E. Application of Access Charges to IntraMTA Traffic Delivered by IXCs. ... 36

F. Phantom Traffic Issues. ... 37

VII. CONCLUSION ... 40

Summary

The Rural Associations listed above seek reconsideration and/or clarification of several aspects of the Commission's *Order* in the above-captioned proceeding.

RLECs are thoroughly committed to expanding broadband services to their customers. However, any *obligation* to provide such services should be established only after a broadband-oriented Connect American Fund (CAF) mechanism that provides sufficient and predictable support is adopted for these carriers. The Associations accordingly first request the Commission reconsider its decision to impose new, unfunded public interest obligations on rural rate-of-return regulated local exchange carriers (RLECs) until such time that a new, sufficient CAF mechanism is in place.

Second, the Associations seek reconsideration of the Commission's imposition of various new cost recovery caps and limitations on RLECs. In particular, the Commission should reconsider the sufficiency of its overall high-cost support budget for RLEC areas and allow for potential expansion of available funds to meet actual broadband needs. The Commission should also reconsider its premature decision to adopt regression-based caps on recovery of capital and operating expenses.

Several other aspects of the *Order*'s approach to cost recovery limitations should be reconsidered as well. Specifically, the Commission should reconsider its decision to set an end-user rate floor at the national average of such rates. By definition, an "average" rate cannot be considered an "artificially low" rate. The Commission should also reconsider several aspects of its decisions regarding phase-out or elimination of the safety net additive (SNA) support mechanism. Additionally, the Commission should reconsider its decision to impose a per-line cap on RLECs' overall legacy high-cost support, as this will not accomplish any significant

savings for the universal service fund (USF), yet will have devastating effects on a small number of RLECs and their customers.

Third, the Commission should abandon its unreasonably stringent approach to considering waivers of rules governing USF disbursements and additional funding for access replacement support. The waiver processes described in the *Order* will impose substantial burdens on small companies, and appear designed primarily to discourage companies from seeking relief. The Commission should instead continue to rely on the "good cause" standard specified in section 1.3 of its rules, and provide a concrete and realistic path to obtaining such waivers where needed to meet the objectives of universal service.

Fourth, the Commission should substantially revise the annual reporting requirements imposed on RLECs by the *Order*. The Commission should instead continue to rely primarily on existing monitoring mechanisms, including those established in cooperation with state commissions under section 254 of the Act. The Commission should also refrain from requiring RLECs to submit audit reports by April 1 of each year, as compliance with this rule may be nearly impossible for most small companies. The burdensome performance reports required under new section 54.313 should also be reconsidered, as regulatory requirements will require RLECs to divert precious resources from providing service to customers to filling out reports.

Fifth, the Commission should reconsider its approach to represcribing the interstate rate of return. The abbreviated notice-and-comment process adopted in the *Order* will not satisfy the hearing requirement of section 205(a) of the Act. The Commission instead needs to follow a two-step process, whereby it would first resolve the numerous flaws it has previously identified with traditional cost of capital analyses as applied to small, non-publicly traded RLECs. At that point, it would be possible for the Commission to conduct a fact-based paper hearing, including

opportunities for parties to present direct cases and rebuttal testimony, that will conform to the hearing requirement of section 205(a), as well as the Administrative Procedure Act.

Finally, the Commission should reconsider several aspects of the intercarrier compensation (ICC) rules adopted in the *Order*. Most critically, the Commission must provide a reasonable opportunity for RLECs to recover interstate costs allocated by the Commission's own rules to switched access rate elements. Under the *Order*, these costs will be relegated to the regulatory and economic equivalent of a black hole. The Commission must resolve this problem either by reconsidering its decision to cap and then reduce carriers' eligible recovery amounts in a lockstep manner, or by permitting RLECs to establish a new rate element designed to recover allocated costs not otherwise recovered via end-user charges or ICC CAF support.

The Commission should also reconsider several other aspects of its ICC rules, including methods used to calculate ICC CAF support. Specifically, the Commission should revise its rules so that baseline interstate revenue requirements are based on actual cost studies rather than tariff forecasts, clarify methods for estimating minutes of use (MOU), and change the proposed base period Fiscal Year to July 1 – June 30 rather than ending it on September 1. The Commission should also revise or clarify rules governing calculation of net reciprocal compensation revenues to include transit costs, clarify the distinction between "local" and "toll" Voice Over Internet Protocol (VoIP) traffic in light of today's telecommunications marketplace, clarify that access charges may be applied to intraMTA traffic routed via interexchange carriers (IXCs), and further strengthen its call signaling rules, as the limited requirements imposed by the *Order* will not be sufficient to address previously-identified problems.

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Pursuant to section 1.429 of the Commission's rules, 47 C.F.R. § 1.429, the rural telephone associations listed above hereby seek reconsideration and/or clarification of certain aspects of the Commission's November 18, 2011 *Order*[1] in the above-captioned proceeding.

[1] *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,*

I. THE COMMISSION SHOULD ADOPT A SUFFICIENT AND PREDICTABLE CONNECT AMERICA FUND MECHANISM *BEFORE* IMPOSING BROADBAND-RELATED PUBLIC INTEREST OBLIGATIONS ON RATE-OF-RETURN CARRIERS.

As carriers based in and committed to serving their communities, rural rate-of-return regulated local exchange carriers (RLECs) are committed to universal broadband service. Although they have obtained impressive broadband build-outs in reliance on existing high-cost support mechanisms, expansion of such services will require additional, predictable support.

The *Order* imposes a number of new broadband-related public interest obligations on eligible telecommunications carriers (ETCs), including RLECs, in connection with receipt of legacy high-cost universal service fund (USF) and/or Connect America Fund (CAF) support, including the requirement that offer broadband service that meets certain minimum performance requirements exceeding what RLECs typically offer today.[2] The Commission further expects that such services will be provided at rates that are "reasonably comparable" to offerings of comparable broadband services in urban areas. The Commission also imposed a series of reporting requirements on USF/CAF recipients with respect to the provision of both voice *and* broadband services to consumers.[3]

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, *Universal Service – Mobility Fund,* WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (rel. Nov. 18, 2011) (*Order* or *FNPRM*).

[2] *Id.* ¶ 206. As of July 2010, approximately 70 percent of RLEC service areas did not have access to the 4/1 Mbps broadband service required under the Order. *E.g.,* Comments of OPASTCO, NECA, NTCA, and WTA, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337 (filed July 12, 2010) at 7. The performance level and extent of RLECs' current broadband service deployments has generally been hampered by high "last mile" facility costs, and the fact that existing support mechanisms do not include support for critical "middle mile" connections to the Internet backbone. *Id.* at 58.

[3] *See* 47 C.F.R. § 54.313(a)(11).

These obligations conflict, however, with many operative provisions of the *Order*. Most glaringly, there is as yet no CAF for RLECs to permit achievement of these objectives. Instead, USF changes applicable to RLECs consist entirely of cuts to existing support mechanisms and additional limits on cost recovery, which together will undermine the ability of RLECs to deploy new broadband services, maintain existing broadband services, and otherwise satisfy the new broadband public interest obligations identified in the *Order*.[4]

If current levels of support have not enabled widespread availability of broadband service meeting the *Order*'s performance metrics, then *cutting that support* will certainly not enable carriers to extend or upgrade service upon "reasonable request" or otherwise. Moreover, even if a carrier receives CAF support as part of ICC reform, that support – which represents an explicitly declining revenue stream to replace lost ICC revenues – cannot reasonably be expected to enable the delivery of standalone broadband services in high-cost areas where it is not available today.

While the Commission repeatedly asserts that its USF and ICC reforms will provide carriers with greater certainty and predictability, *e.g.*, *Order* at ¶¶ 125, 221, 286, 291, the opposite is true: in addition to uncertainty regarding the adequacy of funding under the yet-to-be-determined CAF mechanism for RLECs, along with the unknown impacts of new regression-based limitations on reimbursable capital and operating costs, RLECs are now threatened with greater challenges through the *FNPRM.* These include, but are not limited to: the potential reduction in the authorized rate-of-return; loss of support based on instances of competitive overlap; and, despite Commission assurances to the contrary, potential increases in problems

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[4] *E.g.*, *Order* ¶ 45.

with phantom traffic and access avoidance behaviors during a transition to a mandatory zero rate for all switched services (except transit).

The Commission suggests that "waivers" might somehow allow carriers to obtain support to meet broadband public interest obligations and achieve statutory universal service objectives, but that supposed route is obstructed by both the plain language and clear tone of the *Order*. As an initial matter, and as described below, the process for obtaining a waiver is quite onerous.[5] Moreover, the Commission has warned explicitly that waivers will be difficult to come by.[6] Given prior history, small companies facing the need for emergent relief are unlikely to have any confidence that waivers can be obtained before irreparable harms occur.[7]

It is also unclear how a provider could obtain a waiver for failure to meet the Commission's *broadband*-oriented objectives and related public interest obligations when the waiver process requires a showing "that the reduction in high-cost support would put consumers at risk of losing *voice* services . . . ."[8] An RLEC might be quite capable of providing voice service throughout a massive study area, but face extreme difficulty in delivering *any* level of higher-cost broadband (never mind 4/1 Mbps speeds) to wide portions of that study area at anything approaching an affordable or reasonably comparable rate.

More astounding is the construct that would condition USF support to meet *mandatory* performance obligations upon a *discretionary* waiver; that sequence simply fails to meet any

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[5] *Id.* ¶¶ 542-544; *see also* section III, *infra*.

[6] *Id*. ¶ 540.

[7] *See* Letter from Hon. Greg Walden, Chair, Subcommittee on Communications and Technology, and Hon. Cliff Stearns, Chair, Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, to Chairman Julius Genachowski (dated Dec. 21, 2011) (noting that, as of July 2011, 5,328 petitions, more than a million consumer complaints, and 4,185 license applications that had been sitting for more than two years).

[8] *Id*. ¶ 540 (emphasis added).

notion of sufficiency or predictability required by section 254 of the Act.[9] As an accounting matter the amount of support available under the rules should "tick and tie" to the obligations imposed, rather than leaving carriers to hope that they can "back into" compliance with specific obligations based upon the slim likelihood of obtaining a waiver for additional support. Accordingly, the purported availability of waivers will do little, if anything, to blunt the serious impacts of the caps and cuts that merit reconsideration for the reasons described below.

In the face of cuts to existing high-cost support in the *Order*, with no specific or predictable broadband-focused mechanism in place, and with the threat of more cuts in the *FNPRM*, the Commission should not compel RLECs as a class of carriers to adhere to broadband-focused obligations as a matter of law. It should instead revisit these issues at such time as a new CAF mechanism can be shown to provide sufficient and predictable support that enables them to satisfy such obligations. Specifically, the Commission should refrain from requiring RLECs: (i) to provide broadband service "upon reasonable request" or otherwise; (ii) to provide broadband at rates that are reasonably comparable to those charged in urban areas; or (iii) to provide standalone broadband throughout an entire study area if it is offered in any portion thereof.[10] The Commission should also refrain from requiring RLECs to submit reports of broadband network performance tests, as specified in new section 54.313(a)(11), unless and

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[9] 47 U.S.C. § 254(b)(5).

[10] Among the many items that must be addressed prior to imposition of new service extension requirements is the nature of the "broadband" service RLECs will be expected to provide. That is, while the *Order* defines certain technical characteristics of "broadband service", it does not address whether RLECs can satisfy these requirements by continuing to offer the common carrier *broadband transmission services* they currently provide to their ISP customers, or whether they must now begin offering *broadband Internet access services* directly to consumers in order to continue qualifying for high-cost USF support. *See generally* Comments of NECA, NTCA, OPASTCO, WTA, and ERTA, GN Docket No. 10-127 (filed July 15, 2010). Clarification of this issue is needed before RLECs will even begin to be in a position to comply with the speed, latency, capacity and price reporting requirements imposed by the *Order*.

until such time specific, sufficient and predictable funding is provided for the underlying broadband services. Finally, the Commission should clarify that RLECs will not be required to satisfy any specific performance criteria with respect to broadband services unless and until sufficient funding is available, including the availability of funding explicitly intended to support robust "middle mile" transport.

II. THE SUPPORT CUTS AND COST RECOVERY LIMITATIONS IN THE ORDER MUST BE RECONSIDERED OR CLARIFIED SO AS TO AVOID CONFLICTS WITH THE PUBLIC INTEREST OBLIGATIONS IMPOSED BY THE ORDER, THE GOALS OF THE REFORMS, AND THE NEW UNIVERSAL SERVICE PRINCIPLE ADOPTED BY THE COMMISSION.

A. The Commission Should Reconsider the Sufficiency of its Budget for High-Cost Universal Service.

The *Order*, for the first time, establishes a defined budget for the high-cost component of the USF, set at the estimate for the size of the high-cost program for FY 2011 ($4.5 billion).[11] The Commission asserts that setting the budget at this level will "minimize disruption and provide the greatest certainty and predictability to all stakeholders."[12] Even if true, however, the Commission's budget-setting exercise fails to incorporate an explicit and detailed determination of how this budget (and its particular piece-parts) would be *sufficient*. Once the Commission defines the network facilities and services supported by federal universal service mechanisms, sections 254(b) and (e) of the Act require it to *preserve and advance* universal service via "specific, predictable, and sufficient" support mechanisms.[13]

The *Order* fails to provide any explanation as to how maintaining funding at current levels – or reducing support to entire subsets of carriers of last resort (COLRs) within that budget

[11] *Order* ¶ 125.

[12] *Id*.

[13] 47 U.S.C. § 254(b)(5).

– is consistent with its statutory mandate of sufficiency.[14] The Commission itself has acknowledged that the higher-capacity broadband networks of tomorrow cannot be built with today's funding levels.[15] As discussed above, the budgeted amount for RLEC areas in particular is inadequate when compared to the new public interest obligations imposed by the *Order* and requirements to ensure that services will remain "reasonably comparable" in scope and price going forward. Under the reforms in the *Order* along with those threatened in the FNPRM, few, if any, RLECs will be in position to *advance* broadband, and some may not even be able to sustain the DSL-speed broadband they have deployed today.

The Commission should accordingly adopt a more practical approach to "budgeting" that balances the need for fiscal responsibility with continued deployment and operation of broadband-capable networks in rural areas. The RLEC Plan's "budget target" for rate-of-return service areas of $2 billion to start, growing to $2.3 billion over six years, was aimed to "edge out" broadband to the unserved, while also making sure that consumers in RLEC areas would not be left behind or "leapfrogged" as broadband service capabilities evolve.[16] It provided "headroom" for important mobility objectives and increased deployment in areas served by price cap carriers while accommodating ICC reforms and adequate restructuring. In fixing support for consumers in RLEC areas at $2 billion – *including* ICC restructuring – the Commission's budget will only ensure an ever-widening digital divide to the particular disadvantage of customers in

[14] *Order* ¶ 2.

[15] *See Connecting America: The National Broadband Plan*, FCC (rel. Mar. 16, 2010) at 136-138, 143-148. *See also Omnibus Broadband Initiative*, The Broadband Availability Gap: OBI Technical Paper No. 1 (April 2010).

[16] *See* Comments of NECA, NTCA, OPASTCO, and WTA, WC Docket No. 10-90, *et al.* (filed April 18, 2011) (*Rural Associations April 18 Comments*).

RLEC service areas.[17] The Commission should reconsider its budgeting approach and adopt the RLEC Plan budget as proposed.

At a bare minimum, if the Commission does not adopt the RLEC Plan budget structure it should incorporate an inflation adjustment within the budget set forth in the *Order*. The Commission has recognized the value of inflation adjustments in other contexts. By way of example, in measuring contribution burdens on consumers and businesses, the Commission explains that it will divide total inflation-adjusted expenditures of the existing high-cost program and CAF (including the Mobility Fund) each year by the number of American households and express the measure as a monthly dollar figure.[18] Similarly, section 54.507(a)(1) of the Commission's rules adjusts the E-rate program's annual cap based on the gross domestic product chain-type price index (GDP-CPI) as a measure of inflation.[19] Allowing adjustments to a "target" funding level consistent with the GDP-CPI measure of inflation will at least maintain the target's value and achieve consistency across programs.

[17] The RLEC Plan's proposed budget, as captured in a joint letter signed by and filed with several larger carriers, included a provision pursuant to which AT&T and Verizon would forgo certain funding, if needed, to enable growth in RLEC USF/CAF support from $2 billion to $2.3 billion over several years. *See* Letter from Walter B. McCormick, Jr., United States Telecom Association, *et al.*, to Chairman Genachowski, FCC, WC Docket No. 10-90 (filed July 29, 2011). In other words, as part of the consensus framework, the two largest carriers in the industry *affirmatively and expressly agreed* to enable reasonable growth in RLEC funding over six years through their own initiative. Yet the Commission inexplicably declined to adopt the written offer made by the two largest carriers in the industry to forgo a portion of their own support for the good of rural customers served by the smallest carriers.

[18] *Order* ¶ 58.

[19] 47 C.F.R § 54.507(a)(1).

B. The Commission Should Reconsider Several Aspects of its Caps on Capital and Operating Expenses

The Commission's proposal to apply "regression analysis" caps on recovery of capital expenditures (CapEx) and operating expenses (OpEx) is unlawful and not rational in a number of respects. In particular, the Commission's decision to apply the caps retroactively to investments made prior to the effective date of the Commission's implementing rules is so fundamentally at odds with the Act and basic principles of administrative law that certain parties have sought review of the Commission's *Order* before the appellate courts, in lieu of seeking reconsideration.[20] Other aspects of the Commission's regression analyses approach remain to be determined in the *FNPRM* phase of this proceeding. The Associations expect to file comments on these issues in January 2012.

In this Petition, the Associations ask the Commission to reconsider specific determinations with regard to regression-based caps that appear to pre-judge the operation of the caps prior to allowing interested parties the opportunity to comment on specific methods to be utilized and to analyze the impacts of such decisions. These issues are described below.

Premature Adoption of Regression Analysis-Based Constraints. The Commission's determination to use regression analyses to develop the new caps is premature and improper given that the methodology for doing so is subject to further examination pursuant to the *FNPRM* and Appendix H of the *Order*. Although the Associations understand the Commission may alter this methodology based upon comments, its firm conclusion to utilize regression analyses in the first instance leaves no room to argue that other approaches might be used in

[20] *See, e.g., National Telecommunications Cooperative Association v. Federal Communications Commission* (4th Cir., filed Dec. 8, 2011).

whole or in part as a substitute to achieve the kinds of constraints sought by the Commission.[21] By firmly adopting the use of a regression analysis before giving parties the ability to consider whether this approach truly works or whether other constraints might yield better results, the Commission has ventured down a path that could limit cost recovery in unworkable or unlawful ways. The Commission should accordingly reconsider its conclusion to utilize a regression analysis to develop the new caps, and should state instead that it will *examine* a regression analysis approach such as that in Appendix H, subject to adequate notice and comment, *before* it adopts and implements a particular form of investment or operating expense constraint.[22]

Unlawful Adoption of "Dynamic" Caps. The Commission should reconsider its decision to change the caps each year based upon a refreshed "run" of the regression analyses. This approach creates a "race to the bottom," in which carriers will be encouraged to invest less in plant and spend less on operations – even if the "job to be done" (such as delivering 4/1 Mbps speed broadband) in a given area requires such expenditures – simply to avoid being affected by the caps. Moreover, this dynamic capping does nothing to restore predictability to the high-cost program but instead only exacerbates uncertainty. Under these caps, it appears that a carrier could actually reduce or maintain existing investment and expense levels during a given year but still suffer unexpected reductions in its HCLS (and/or ICLS) if its "peer group" has changed or if its existing peers have reduced their costs faster.

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[21] The Associations suggested a reasonable constraint on investment as part of the RLEC Plan. *See Rural Associations April 18 Comments,* Appendix A.

[22] The Commission's decision to delegate to the Wireline Competition Bureau the authority to establish regression-based constraints raises serious legal concerns as well. *E.g.,* Letter from Michael R. Romano, NTCA, to Marlene H. Dortch, FCC, WC Docket No. 10-90, *et al.* (filed Oct. 21, 2011) at 2.

The Commission dismissed these concerns in the *Order* by noting that the current HCLS mechanism is unpredictable.[23] This is hardly reassuring. The Commission should *fix* uncertainty within the HCLS mechanism rather than exacerbate it by introducing more unpredictability. To remedy this shortcoming, the Commission should find that any caps based upon regression analyses will, once developed, remain in place for at least seven years before being "refreshed." This would give carriers a more reasonable time horizon against which to plan investments and adjust operations than a cap that dynamically and unpredictably changes each year.

Premature Application of Caps to ICLS. Application of new caps on cost recovery through ICLS is hasty and injudicious. Even as it adopts this requirement, the *Order* acknowledges that neither the Commission nor any party has any sense yet of how to implement this or the effects of it.[24] The Associations understand the Commission's desire to *examine* this issue, and welcome participation in a thorough debate about *whether* such a measure should be adopted. But to adopt this approach first and then try to figure out later if and how it can work – without any discussion or consideration of the impacts of doing so – is highly questionable as a matter of reasoned rulemaking. The Commission should reconsider this decision and state instead that it will *examine* the potential application of the new caps to ICLS, subject to adequate notice and comment.[25]

[23] *Order* ¶ 220.

[24] *Id*. ¶ 225.

[25] At a minimum, the Commission should reconsider the timing for extension of the corporate operations expense cap to the ICLS mechanism, and the effective date of all other operating expense caps to be developed through the regression analyses. Under the *Order*, the corporate operations expense cap will immediately extend to ICLS well before any mechanisms that might permit additional opportunities for interstate cost recovery through high-cost USF (such as proposed in the RLEC Plan) are adopted. The expense caps to be developed through the regression analyses would apparently take effect immediately upon adoption as of July 1, 2012,

"Double Capping" of HCLS. The Commission should reconsider its decision to siphon support away from the HCLS mechanism based upon application of the new caps.[26] The HCLS mechanism is already subject to an overall cap that results in many carriers receiving less support than they would by straightforward operation of the rules.[27] For this reason, in the context of the current corporate operations expense cap, any support reductions that occur as a result of the application of that current cap are redistributed to other HCLS recipients – these carriers are simply receiving support they would have received but for the overall cap on the mechanism.

This diversion of HCLS means that some carriers who are already suffering from a shortfall in cost recovery due to the overall cap will see no relief. The Associations understand that the Commission's intent is to preclude the "recycling" of savings from the new caps to those RLECs who are affected in some way by those caps.[28] But this policy is punitive in that it effectuates a "double cap" – the overall cap on HCLS and then the new caps – on RLECs who need such support in the first instance precisely because they serve high-cost areas.

Indeed, this policy runs the risk of penalizing RLECs who are highly "efficient" in nearly every way that the Commission might measure. For example, a carrier may exceed the benchmark in a single cost category or two by a minimal amount, say $1,000, but otherwise be hundreds of thousands of dollars below the benchmarks in all other cost categories subject to the

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even though no carrier will have seen those caps prior to that time. To ensure that carriers have adequate opportunity to adjust their operations for compliance with these new caps, the Associations suggest the Commission at a minimum delay implementation of *any* new operating expense caps, including extension of the corporate operations expense cap to ICLS, until no sooner than January 1, 2013.

[26] *Id.* ¶ 220.

[27] *See* 47 C.F.R. § 36.601(c).

[28] *See Order* ¶ 220. (support will only be redistributed to those carriers "whose unseparated loop cost is not limited by operation of the benchmark methodology").

regression analysis. Yet the Commission's policy would deny that RLEC the benefit of any "redistributed" HCLS. This is plainly irrational and contrary to the intent of the law.

The Commission's decision seems to overlook the undisputable fact that these are small companies who serve as COLRs in high-cost areas in which no other entity would serve. Denying these carriers the chance to recover more *but still not all* of the high loop costs associated with serving these large, sparsely populated areas is patently inconsistent with the *Order*'s stated objectives for universal broadband service availability.[29] The Commission should reconsider its decision with respect to the handling of HCLS reductions resulting from application of the new caps, and find instead that the entirety of those reductions will be redistributed to other RLECs – including those impacted by new caps -- within the overall capped HCLS mechanism.

C. The Commission Should Reconsider Or Modify Several Of The Other Capping Mechanisms Adopted In The Order.

1. The Commission Should Determine Reasonably Comparable Rates on the Basis of Standard Deviations, Rather than Arithmetic Average.

The *Order* limits high-cost support where end-user rates do not meet an urban rate floor based on the national average of the local rate plus state-regulated fees.[30] The Commission's intent is to reduce support for "artificially low" end-user rates.[31] The Associations submit that

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[29] *E.g.*, *id.* ¶¶ 17, 22, 28, 48, 87.

[30] *Id.* ¶ 238.

[31] *Id.* ¶ 234.

the use of a statistical measure such as the standard deviation would identify more accurately those carriers whose rates are so-called "artificially low" or beyond reasonable comparability.[32]

There is nothing "artificially low" about an end-user rate that is a penny or even a dollar below the national average. Moreover, the Commission has previously relied upon standard deviations to establish reasonable comparability for USF purposes.[33] The plain language of the statute contemplates variances of the type accommodated by standard deviations as it instructs the Commission to ensure "reasonable comparability."[34] For these reasons, the Commission should reconsider the rule and replace the arithmetic average with a statistical measure to determine instances where end user rates are considered "artificially" low.

2. The Commission Should Reconsider Several Aspects of its Decision with Respect to the Elimination of Safety Net Additive Support.

In considering changes to the safety net additive (SNA) support mechanism, the Commission declined to adopt the Associations' suggestion that SNA qualification be based on total year-over-year changes in total telecommunications plant in service (TPIS), rather than on *per-line* changes in TPIS. It concluded instead that beneficiaries whose TPIS increased by more than 14 percent over the prior year at the time of their initial qualification should continue to

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[32] Arithmetic averages are influenced unduly by the presence of outliers, both above and below the mean. Therefore, even where the predominant number of rates is clustered closely to each other, the inclusion of a substantially higher or lower figure can produce an average that deviates from the cluster. In contrast, the standard deviation accommodates favorably a distribution of data across a range.

[33] *E.g.*, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Joint Petition of the Wyoming Public Service Commission and the Wyoming Office of Consumer Advocate for Supplemental Federal Universal Service Funds for Customers of Wyoming's Non-Rural Incumbent Local Exchange Carrier*, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd. 4072 (2010) ¶ 43, n. 144; *see also Order* ¶ 592.

[34] *See, e.g.*, 47 U.S.C. § 254(b)(3). It is hard as a matter of logic to see how a single end-user rate could be considered both "artificially low" and yet "reasonably comparable" at the same time. Yet a benchmark floor based upon the national average would enable just such a result.

receive SNA support for the remainder of their eligibility period. For remaining beneficiaries, SNA support will be phased down in 2012.[35] No new SNA support for costs incurred after 2009 will be provided.[36]

In reaching these determinations, the Commission reasoned that even if SNA support is based on total (rather than per-line) TPIS, it would not ensure proper targeting or efficiency in investing.[37] The Commission's analysis failed to consider, however, that other provisions of the *Order* designed to limit recovery of CapEx and OpEx amounts via other high-cost mechanisms would also ensure that investment eligible for SNA support under the total TPIS test would be similarly confined, thereby restoring SNA to its original purpose. The Associations therefore request that the Commission reconsider its decision to eliminate SNA altogether, and instead adopt new qualifications for SNA support based upon total year-over-year changes in TPIS, as previously recommended.

At a minimum, the Commission should reconsider its conclusion that no SNA will be available for costs incurred between 2009 and the effective date of the *Order*. The Commission reasons that carriers are not "entitle[d]" to such support, and that "since early 2010, the Commission has given carriers ample notice that we intended to undertake comprehensive universal service reform in the near term."[38] This purported justification assumes the industry should have expected the Commission to engage in retroactive rulemaking. Parties aware of impending rule changes might reasonably be expected to reconsider *future* investment plans, but it is irrational to suppose carriers would refrain from making investments that qualify under

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[35] *Order* ¶ 249. For this group, SNA support will be reduced 50 percent in 2012, and eliminated in 2013.

[36] *Id.*

[37] *Id.* ¶ 251.

[38] *Id.* note 409.

current rules simply because future rules *might* change in some unforeseeable manner.[39] This outcome is patently inconsistent with "familiar considerations of fair notice, reasonable reliance, [and] settled expectations" embodied in the general prohibition against retroactive rules.[40]

Finally, the Associations request that the Commission reconsider the pace of its phase-down of support for those who are receiving SNA as a result of line loss. These recipients are often companies struggling to adjust to market developments, and the precipitous loss of SNA – coupled with many of the other significant reforms contained in the *Order* – could place some of these companies in significant peril. At a minimum, the Commission should therefore extend the phase-down of SNA support where attributable to line loss from two to four years, so that SNA support would be eliminated at the end of 2015 rather than 2013.

3. The Order's Adoption of a Per-Line Cap on High-Cost Support Imposes Substantial Damage on Small Companies with Little Aggregate Public Interest Benefit.

The Commission should reconsider its imposition of a $250 monthly per-line high-cost cap.[41] First, the *Order* provides no explanation whatsoever as to the basis for choosing $250 per month as a limit on per-line support. What is known, however, is that the rule as adopted will have limited benefit but devastating impacts on affected small companies. While the Commission has acknowledged an opportunity for waiver, the anticipated administrative and

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[39] Strict application of this logic would lead to the conclusion that no one should invest in broadband-capable network deployment in 2012 in reliance upon high-cost USF support because their support might change as a result of the pending *FNPRM*.

[40] *See, Marie v. Securities and Exchange Commission,* 374 F.3d 1196, 1207 (D.C. Cir. 2004) *(Marie v. SEC)* (SEC disciplinary action against auditors for 1994 actions invalidated because standard imposed was not effective during period of auditors' actions), *quoting Landgraf v. USI Film Products,* 511 U.S. 244 (1994). The fact that USF processes in some cases incorporate delays between expenditures and recovery does not mitigate the general principle that the *impact* of regulations should be prospective-only.

[41] *Order* ¶ 274.

financial burdens of executing those waivers as discussed below argue for reconsideration of the rule.[42]

The Commission's imposition of a per-line cap on individual carrier high-cost support is intended, ostensibly, to be "consistent with fiscally responsible universal service reform."[43] This rule does not achieve that objective. By the Commission's own measure, the cap would only affect a few high-cost RLECs.[44] Savings from this measure would amount to less than three-quarters of one percent the total high-cost support received by RLECs. For affected end-users, however, the impacts would be disastrous – carriers would need to raise monthly rates anywhere from about nine dollars to $1,200 in order to recover resulting revenue shortfalls.[45]

The Associations do not dispute the need to ensure fiscal responsibility. But the per-line cap does not achieve that goal. There has been no finding that carriers requiring high per-line support amounts are, by definition, "irresponsible" or that their costs above $250 per line per month were not used, useful, or lawful; in fact, the FCC has recognized that the cost of providing terrestrial phone service in some rural areas is significant.[46] Nor are these carriers (or any other

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[42] *Infra,* section III.

[43] *Order* ¶ 273.

[44] *Id.* ¶ 277. ("We emphasize that virtually all (99 percent) of incumbent LEC study areas currently receiving support are under the $250 per-line monthly limit. Only eighteen incumbent carriers and one competitive ETC today receive support in excess of $250 per-line monthly, and as a result of the other reforms described above, we estimate that only twelve will continue to receive support in excess of $250 per-line monthly.")

[45] *Id.* at 46.

[46] *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, 26 FCC Rcd. 4554 (2011) ¶ 210.

RLECs) placing significant strains on the high-cost USF program such that these draconian measures are warranted – as noted several times before in this record, RLECs' total high-cost USF support increased by only 3 percent on average between 2006 and 2010.[47]

The Commission should accordingly set aside monthly per-line caps and not consider similar measures until the impacts of other constraints the Commission has adopted are evaluated. Alternatively, the per-line cap should be applied on a prospective basis only, after costs of current investment have been recovered. Finally, if the Commission declines to reconsider the cap in the short-term, it should provide for an expedited waiver process, avoid applying the per-line cap while a waiver request is pending, and also lift the cap when other caps are imposed, since those constraints should have a broader impact on the Commission's objective to meet high-cost funding budgets.

4. The Commission Should Not Begin Phasing Out Support in Areas with Competitive Overlap Without Addressing Ongoing RLEC Obligations as COLRs and ILECs.

The *Order* states that the Commission has adopted a rule phasing out all high-cost support in study areas where an unsubsidized competitor, or combination of unsubsidized competitors, offers voice and broadband service for 100 percent of residential and business locations in an incumbent's study area.[48] Methods to identify overlaps and how to adjust support where overlaps are less than 100 percent will be considered in the FNPRM. [49]

Neither the *Order* nor the *FNPRM* address, however, the continued application of COLR obligations to RLECs facing elimination or reductions in support as a result of competitive overlap, or even whether such companies will continue to be treated as "incumbent" LECs under

[47] *Id.* at 59, Figure 7. *See also Rural Associations April 18 Comments* at 56, note 116.

[48] *Order* ¶ 283.

[49] *Id.* ¶¶ 1061-78.

the Act. These issues are critical and must be addressed prior to implementation of any such rule. The Associations accordingly request the Commission reconsider the Order insofar as it would require any phase-out of support in RLEC areas with 100 percent overlap, at least until such time that questions related to RLECs' ongoing obligations as COLRs and ILECs are resolved.

III. THE ORDER ESTABLISHES UNREASONABLY STRINGENT STANDARDS FOR OBTAINING WAIVERS OF THE SUPPORT REDUCTION RULES AND FOR REQUESTING ADDITIONAL CAF ICC SUPPORT.

Both the high-cost support waiver petition process established in section VII.G of the *Order* ("USF waiver petition process") and the additional access replacement support request process established in section XIII.G thereof ("ICC additional support request process") impose unreasonable burdens on RLECs and other small businesses, and should be reconsidered.

The Commission's general rule governing waiver requests permits the filing of relatively brief, straightforward and inexpensive petitions for waiver.[50] Existing procedures also permit the Commission to exercise broad discretion to waive a rule where particular facts make strict compliance inconsistent with the public interest, and to take into account considerations of hardship, equity, or more effective implementation of overall policy on an individual basis.[51]

In stark contrast, the new high-cost USF waiver petition process requires submission of extraordinarily detailed information that will be difficult, if not impossible, for small companies

[50] *See, e.g., Petitions for Waiver of Universal Service High-Cost Filing Deadlines*, WC Docket No. 08-71, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Cedar-Wapsie Communications, Inc. Petition for Waiver of Section 54.904(d) Filing Deadline For Submission of Annual Interstate Common Line Support Certification, DialToneServices, L.P. Petition for Waiver of Section 54.307(c) of the Commission's Rules*, *et al.,* Order, 26 FCC Rcd. 11069 (2011).

[51] *Id.* ¶ 10, citing *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990) and *WAIT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969).

affected by funding cuts to assemble and submit.[52] ICC additional support requests also require RLECs to perform burdensome and outdated separations studies.[53] The type of RLEC most likely to consider filing a USF waiver petition and/or an ICC additional support request is one for whom loss of substantial USF and/or ICC revenues will threaten its very ability to survive. Cuts in support resulting from the changes announced in the *Order* will likely impose significant hardship on many small companies, and may require them to reduce service and eliminate jobs that are important to maintaining service, as well as the economic health of their local communities. And, yet, the Commission would have these companies divert resources to prepare and prosecute elaborate and extensive waiver petitions, while at the same time imposing new limits on recovery of such expenses from support mechanisms.

The *Order* fails to assess the impacts of these burdens on small companies.[54] Nor does the Commission consider whether any reasonable alternatives might be employed to avoid such burdens. Rather, by making it painfully apparent that such waiver requests will be subjected to a

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[52] USF waiver petitions under the *Order* will require, at a minimum, submission of (1) extensive and expensive geographic and demographic information; (2) information regarding the existence or lack of alternative voice providers, and whether any such alternative providers offer broadband; (3) Part 32 and Part 36 accounting information regarding unused and/or spare equipment; (4) detailed breakdowns of corporate operations expenses; (5) descriptions of all end-user rate plans; (6) lists of all non-voice services provided over supported plant; (7) descriptions of all cost allocation procedures; (8) audited (if available) or unaudited financial statements for the most recent three fiscal years (including costs and revenues of unregulated operations); (9) information regarding outstanding loans (including loan terms and recent restructuring discussions); and (10) information regarding the specific facilities that will be taken out of service if the waiver is not granted. *Order* ¶¶ 542-543.

[53] *Id.* ¶ 932

[54] The final Regulatory Flexibility Analysis (RFA) in Appendix O is deficient in that it does not address the cost and burden of the USF waiver petition process or the ICC additional support request process upon RLECs and other small businesses. Although the Commission recognizes that RLECs are non-dominant small businesses for RFA purposes, it does not consider or adopt any procedures that would make either process less burdensome and less expensive for RLECs and other small businesses. *Id.*, Appendix O ¶ 45.

rigorous review "comparable to a total company earnings review" and that they will not be granted except in extreme circumstances,[55] the Commission's "waiver" process appears to be nothing more than a fig leaf, designed to make small companies jump through administrative hoops in futile attempts to pursue relief.[56]

On reconsideration, the Commission should revise both the USF waiver petition process and the ICC additional support request process to make them much less burdensome and more equitable and attainable for RLECs and other small companies.[57] Specifically, the Commission should discard the various hurdles specified in the *Order* and instead simply apply the "good cause" standard applicable to waiver requests generally under section 1.3 of the rules.

If the Commission retains its stringent and inequitable waiver processes, it should afford RLECs the option to sub-divide their study areas and terminate service to portions thereof if their petitions for additional USF and/or ICC support are denied. Whereas this is a "solution" that RLECs do not desire, there is concern that instances may arise where the Commission's

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[55] *See, e.g.*, *Order* ¶ 540.

[56] Companies are also likely to be discouraged from filing such waiver requests by the prospect of lengthy delays in receiving responses. Relatively simple waivers of high cost support filing deadlines typically take about five months for processing, but many petitions languish for years. *See, e.g., Allo Communications Petition for Waiver of Section 54.307(c) of the FCC's Rules et al.,* CC Docket No. 96-45 and WC Docket No. 08-71, *et al*., Order, 26 FCC Rcd. 6178 (2011) (waiver petitions filed from 11.5 months to 5.2 years earlier); *Iowa Telecom Petition for Interim Waiver of the Commission's Universal Service High-Cost Loop Support Mechanism,* WC Docket No. 05-337, Order, 25 FCC Rcd. 5573 (2010) (waiver petition filed over four years earlier).

[57] The Commission's selective approach to imposing support cuts and reductions on RLECs, while proactively discouraging small companies from seeking relief, is patently unfair in comparison to its treatment of larger carriers like Verizon and AT&T. Based on a review of Verizon and AT&T's 2010 Annual Reports, for example, each of these companies had average annual net income during the 2001-2010 period in the range of $9.0 billion. That is, they each could fund the entire proposed $4.5 billion annual high-cost budget about twice. Yet, the *Order* will potentially provide these carriers with substantial new CAF and Mobility Fund support (as well as major access and reciprocal compensation savings) without any reference whatsoever to whether such funding is actually needed in light of their "total company earnings."

broadband service requirements are so burdensome, and where support is so limited, that RLECs may have no choice but to stop serving the more expensive portions of their study areas to prevent their entire company from spiraling into bankruptcy, leaving customers in those areas without service. This result would be in direct conflict with the universal service goals of the Act.

Finally, given the serious potential consequences of support reductions to end users, and the history of substantial delay in processing waiver petitions, the Commission should suspend implementation of any support reductions pending release of a final order on submitted waiver petitions regardless of what standard is applied in considering such waivers.

IV. NEW RULES IMPOSING ANNUAL REPORTING REQUIREMENTS ON RLECs ARE UNDULY BURDENSOME AND SHOULD BE SUBSTANTIALLY REVISED.

The new annual federal reporting requirements in section 54.313 of the Commission's rules should be reconsidered, and limited in both scope and content. They not only override established and effective state commission reporting and monitoring processes without any showing they are defective, but also impose expensive, unduly burdensome, and in some cases impossible information requirements and deadlines upon RLECs and other small companies.

Virtually all RLECs were designated as ETCs by their state commissions during the initial implementation of the Telecommunications Act of 1996 and have been subject to state commission ETC monitoring and reporting requirements since that time. Unless their state commission independently implemented some or all of the reporting requirements that the

Commission adopted in 2005 for FCC-designated ETCs,[58] these RLECs have not heretofore been subject to federal ETC monitoring and reporting requirements.[59]

The Commission should accordingly reconsider and reduce the scope of section 54.313 to encompass annual filing requirements solely for ETCs designated by the Commission pursuant to section 214(e)(6) of the Act. Whereas the Commission can always recommend or suggest reporting requirements to the states, it should continue to respect the rights and discretion of state commissions to maintain reporting requirements and monitoring procedures for state-designated ETCs that are congruent with the particular needs, resources and circumstances of each state.

Moreover, imposing the new federal reporting requirements on small RLECs will inflict substantial additional regulatory burdens and filing expenses on these entities.[60] For example, it will be very difficult, if not impossible for most privately-held RLECs to comply with section 54.313(f)(2)'s mandate for the filing of a complete, audited annual financial report (including non-regulated revenue) by April 1 of each year.[61] Obtaining outside auditing services during the January 1 to April 1 period is particularly problematic because accounting firms are overwhelmed with year-end financial reports and audits for publicly traded companies as well as

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[58] 47 C.F.R. § 54.209(a).

[59] The Commission has repeatedly recognized that the USF and ICC are "hybrid state-federal programs" and that the states need to remain "key partners" as these programs evolve (*Order* ¶ 15). The *Order* provides no evidence of inadequate, negligent or otherwise unsatisfactory monitoring of state-designated ETCs by state commissions during the more than 14 years that they have been responsible for that task. In fact, the Commission has retained its procedures and requirements for the annual October 1 state commission certifications pursuant to section 54.314.

[60] Again, the Commission's RFA in Appendix O fails to address the major new burdens and costs that new section 54.313's requirements will place on RLECs and other small businesses.

[61] Rural Utilities Service (RUS) procedures require RLECs and other borrowers to submit audited financial reports to RUS by April 30 of each year, but RUS routinely grants formal and informal extensions of this filing date, and does not impose self-effectuating penalties or funding reductions like those included by the Commission in section 54.313(j) for late filings.

corporate and individual tax returns.[62] A significant number of RLECs also participate in wireless partnerships and other joint ventures, often with larger carriers over whom they have no control or influence. Such RLECs often do not receive their year-end financial statements and/or K-1 partnership tax forms until March or months later, and therefore cannot prepare their consolidated financial statements for review by external auditors in time to meet an April 1 deadline. This requirement will also be particularly onerous for companies that have not been required by regulators, investors or lenders to conduct financial audits during recent years, and who therefore do not have recently-audited financial statements on which to base reports.

The self-effectuating penalties of section 54.313(j) will greatly exacerbate the difficulties and severity of the April 1 deadline. RLECs who through no fault of their own are unable to meet the current April 1 filing deadline stand to lose approximately 25 percent of the already reduced annual USF and ICC support that they urgently need to sustain their existing operations (and will lose another 25 percent if they cannot meet the secondary July 1 date). Section 54.313(j) is also far more onerous than similar prior rules that applied to individual high-cost support mechanisms because it reduces an ETC's entire USF and CAF support.

As noted above, the annual network performance tests required by section 54.313(a)(11) of the Commission's rules constitute another burdensome and expensive undertaking for RLECs, particularly inasmuch as the reforms adopted in the *Order* fail to provide support for the services these tests are intended to analyze. However, even if these services were being supported, conducting network performance tests in the large and sparsely populated farming, ranching, mountain, forest, desert and tundra areas served by many RLECs will require hundreds of man-

[62] *See* Letter from David M. Marlett, Marlett and Associates, to Marlene H. Dortch, FCC, WC Docket No. 10-90, *et al.* (filed Dec. 27, 2011).

hours, as well as the diversion of vehicles and monitoring equipment that would be better used for providing quality service to rural consumers and businesses.[63]

It would be far more reasonable for the Commission to reduce such regulatory burdens and encourage small carriers to expend their decreasing revenues upon facilities, maintenance and service to customers. The Commission should accordingly limit the scope of its reporting requirements to FCC-designated ETCs and reduce the significant economic burdens placed upon RLECs and other small entities by (1) revising the filing deadline for RLEC annual reporting from April 1 to September 1; (2) establishing a simplified waiver process that will allow RLECs to avoid the harsh consequences of section 54.313(j) if they cannot meet the filing deadline for reasons beyond their control or other good cause; and (3) establishing simplified and less expensive network performance testing and reporting requirements for RLECs and other small entities.

Finally, the Commission should treat any reports submitted by carriers pursuant to section 54.313 as confidential and proprietary, and exempt from disclosure under the Freedom of Information Act. At a minimum, the Commission should make clear carriers submitting such reports may obtain confidential treatment pursuant to standard protective orders.[64]

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[63] As also noted above, *see supra* note 10, it is not at all clear how RLECs providing only broadband transmission services can be expected to comply with the end-to-end broadband service reporting requirements specified in section 54.313 in any event.

[64] *E.g.*, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *et al.*, Protective Order, 25 FCC Rcd. 13160 (2010); Supplemental Protective Order, 26 FCC Rcd. 12795 (2011).

V. THE COMMISSION MUST ESTABLISH CLEAR RULES GOVERNING THE RATE OF RETURN REPRESCRIPTION PROCESS BEFORE INITIATING A REPRESCRIPTION HEARING.

The informal notice-and-comment procedures the Commission intends to follow to represcribe the authorized interstate rate of return are insufficient to meet the hearing requirement of section 205(a) and relevant provisions of the Administrative Procedure Act (APA) and must accordingly be reconsidered.

The Associations have no objection to the Commission's decision to waive portions of the Part 65 rules that have clearly become obsolete (*e.g.*, rules requiring service of paper copies, page limits, etc.). Nor do the Associations expect the Commission to return to the "trial-type" procedures previously used to prescribe the rate of return. The Commission must, however, follow a two-step process whereby it first addresses identified flaws in current substantive rules governing rate-of-return represcriptions. At that point it may conduct a hearing based on such rules, using procedures that are sufficiently rigorous for the adjudicative, adversarial fact-finding process required under section 205(a) of the Act and the APA.

A. The FCC Must First Adopt New Substantive Rules Governing the Represcription Process Before It Takes Evidence to Determine a Reasonable Rate-of-Return.

More than 20 years ago, the Commission concluded its Part 65 rules were deeply flawed and, as such, could not be used, without revision, for a rate of return prescription.[65] Among other things, the FCC admitted its methodology for determining "comparable firms" was deficient.[66] It further stated that it did not know how to account properly for the fact that many

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[65] *Represcribing the Authorized Rate-of-Return for Interstate Services of Local Exchange Carriers*, Order, 5 FCC Rcd. 7507 (1990).

[66] *Refinement of Procedures and Methodologies for Represcribing Interstate Rates of Return for AT&T Communications and Local Exchange Carriers;* and *Represcribing the Authorized Rate of*

RLECs are locally owned and not publicly traded.[67] The Commission, however, never adopted revised regulations addressing these and other flaws.

The Commission apparently expects these issues will be worked out via the FNPRM. Given the significance of the support that flows from these rules to RLEC stability and service delivery, the Commission cannot conduct a fair, fact-based hearing based on either the old, flawed rules or revised rules that have not yet been adopted. A rate of return prescription based on a record compiled in this manner is effectively "rate-making on the fly," and will almost certainly be overturned by a court as arbitrary and capricious, particularly insofar as the Commission has not explained any reason why its earlier findings regarding flaws in traditional methods used to estimate the cost of capital for RLECs are no longer a concern. Methodology questions raised in the FNPRM must be resolved, and new "rules of the road" announced, before the Commission can legitimately conduct a represcription hearing under section 205(a).

B. The Abbreviated Informal Notice and Comment Procedures Described in the FNPRM Will Not Satisfy Section 205(a)'s "Hearing" Requirement.

A section 205(a) hearing need not be a trial-type proceeding – "paper hearing"

Return for Interstate Services of Local Exchange Carriers, Order, 5 FCC Rcd. 197 (1989) ¶ 47. The FCC must evaluate earnings of "comparable firms" and ensure firms selected for evaluation have similar risks to the RLECs. *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695 (D.C. Cir. 2007).

[67] *Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, Notice of Proposed Rulemaking, 7 FCC Rcd. 5023 (1992) ¶ 6. Other Part 65 concerns were raised by the FCC in an even earlier notice of proposed rulemaking. *Refinement of Procedures and Methodologies for Represcribing Interstate Rates of Return for AT&T Communications and Local Exchange Carriers*, Notice of Proposed Rulemaking, 2 FCC Rcd. 6491 (1987). The problems identified included: 1) groupings of carriers in light of regulatory and market changes; 2) possible prescription of a return on equity only; 3) use of Capital Asset Pricing Model (CAPM); and 4) use of accounting data to segregate overall company risk by jurisdiction or line of business.

procedures may be used instead.[68] But contrary to claims, the abbreviated notice and comment procedures the Commission intends to follow in this proceeding will not satisfy section 205(a)'s hearing requirement.[69] This is because rate of return represcription proceedings are "adversarial in nature and depend upon a thorough fact-based inquiry that develops a great amount of probative evidence."[70]

The Commission cannot avoid these requirements simply by "waiving" its Part 65 rules governing represcriptions.[71] No explanation is given as to why the Commission's prior statements regarding the need for adjudicative fact-finding – which underlie the Part 65 rules – are no longer operative.[72]

Key to the ability to participate fully in a rate-of-return prescription hearing is access to two basic tools: (1) disclosure of the information and assumptions underlying the factual submissions of any parties seeking lower rates of return; and (2) the ability to probe others'

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[68] *Order* ¶¶ 641-642. *Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers*, Report and Order, 59 Rad. Reg. 2d (P&F) 651 (1985); *Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes*, Report and Order, 10 FCC Rcd. 6788 (1995) ¶¶ 51-57 (*Rate of Return Streamlined Rules R&O*).

[69] *Id.* ¶ 51. Instances where the Commission has used "pure" notice and comment procedures to prescribe rates and tariff regulations have typically involved policy matters requiring determination of legislative facts as opposed to adjudicative facts. For example, the Commission used informal notice and comment procedures to prescribe tariff regulations that permitted the resale of interstate private lines (*AT&T v. FCC,* 572 F.2d 17 (2nd Cir. 1978)) and the establishment of ceilings for subscriber line charges (SLC) (*Access Charge Reform*, CC Docket No. 96-262, First Report & Order, 12 FCC Rcd. 15982 (1997) ¶¶ 75-87, *aff'd Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998)).

[70] *Rate of Return Streamlined Rules R&O* ¶ 51.

[71] *Order* ¶ 642.

[72] Informal notice and comment procedures are particularly inappropriate where, as here, commenters are also expected to address a multitude of complex USF and ICC reform issues in addition to presenting the equivalent of a direct case on RLEC cost of capital, all within a very short time frame.

submissions for weaknesses and errors. Existing Part 65 rules address both.[73]

The Commission should accordingly reconsider its decision to conduct an abbreviated all-in-one represcription proceeding utilizing inadequate notice and comment procedures. It should instead first determine what methods will be used to represcribe the authorized rate of return for RLECs, and it must then conduct an adjudicative hearing sufficient to meet section 205(a)'s requirements. At a minimum, the Commission should clarify procedures governing presentation of data and discovery.[74] The Commission should also reinstate the 60-60-21-day time frames for adversarial filings set forth in section 65.103 of its rules. This is critical for RLECs with limited resources to develop the data needed to prepare direct cases, to obtain the services of qualified experts to analyze this data, and to respond fully to adversarial filings.

VI. RECONSIDERATION AND/OR CLARIFICATION IS REQUIRED REGARDING THE APPLICATION OF NEW INTERCARRIER COMPENSATION RULES ADOPTED IN THE ORDER.

A. The Commission Must Provide a Reasonable Opportunity for Rate-of-Return Carriers to Recover Interstate Costs Allocated to Switched Access Rate Elements.

Under current Commission Part 36, 64 and 69 cost allocation rules, RLECs are required to allocate costs between the interstate and intrastate jurisdictions and assign portions of those costs to specific access rate elements for recovery from a combination of charges assessed upon end users and interexchange carriers, along with high-cost universal service support mechanisms. The *Order*, however, caps and then reduces charges that may be assessed upon other carriers for

[73] Section 65.105, for example, combines mandatory disclosure and limited discovery. Of note, while the *Order* waives Part 65 rules governing service of process and related matters, this provision is not explicitly addressed. *Order* ¶¶ 643-645. It thus remains unclear whether these procedures will be available to parties in the proceeding.

[74] *Id.*

switched termination and permits RLECs to recover only a portion of the resulting shortfall from a new end-user charge (the Access Recovery Charge (ARC)) and a new interstate recovery mechanism (CAF ICC Support), which is scheduled to be reduced at a rate of five percent per year.[75] Since existing cost allocation rules remain in effect, however, RLECs are mathematically required to allocate expenses and investments to the equivalent of a regulatory black hole, with no opportunity whatsoever for recovery.

The Commission seeks to justify this result by asserting that rate-of-return carriers are now "off of rate-of-return based recovery specifically for interstate switched access revenues."[76] But in simply declaring that RLECs no longer recover switched access costs via rate-of-return regulation, the Commission failed to address the numerous objections raised in comments to this result.[77] If the Commission's intent was to implement some form of incentive regulation system for RLECs' switched access services, it failed to provide any basis for why earlier concerns, in particular issues surrounding the need to develop appropriate and fair productivity factors for RLECs, suddenly no longer apply.[78]

To resolve these concerns the Commission must provide a reasonable method for RLECs to recover costs allocated to switched access elements under current rules. This may be accomplished either by (a) reconsidering the decision to cap and then reduce annually carriers'

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[75] *Id.* ¶¶ 850-853.

[76] *Id.* ¶ 900.

[77] Comments of NECA, NTCA, OPASTCO, WTA, and the Rural Alliance, WC Docket No. 10-90, *et al.* (filed July 12, 2010) at 45-62 (*Rural Associations July 12 Comments)*.

[78] *Id.* The Commission's analysis of *average* reductions in switched access revenue requirements among RLECs, *Order* ¶¶ 885-887, does not provide an adequate foundation for assuming that *individual* RLECs will achieve such productivity gains. To the contrary, there is and will continue to be tremendous variance among RLEC revenue requirement trends, which in turn will cause some to experience significant shortfalls as their eligible recovery amount declines year after year.

eligible recovery amounts, or (b) permitting RLECs to establish a new rate element applicable to interexchange carriers (which may be flat-rated) designed to recover costs assigned to existing switched rate elements in excess of those recovered via ARCs and CAF ICC Support. Otherwise, put quite simply, neither switched access costs nor the "additional costs" of transport and termination will be recoverable.

B. Mechanics of CAF ICC Support Calculations.

For rate-of-return carriers, the *Order* specifies that the "Rate-of-Return Eligible Recovery" will be calculated from a carrier's "Rate of Return Baseline" less its "ICC recovery opportunity" for that year. The *Order* indicates that the starting point for calculating the Rate-of Return Baseline will be a rate-of-return carrier's 2011 interstate switched access revenue requirement, plus its FY2011 intrastate switched access revenues for rates capped or reduced by the *Order*, plus its FY2011 net reciprocal compensation revenues.[79] Several aspects of this calculation require reconsideration and/or clarification.

1. Rate-of-Return Baseline Interstate Revenue Requirements Should Be Based on Actual Cost Studies Rather than Tariff Forecasts.

The rules governing calculation of the Rate-of-Return Baseline generally specify that rate-of-return carriers must use projected interstate switched access revenue requirements associated with their most recent tariff filing.[80] For purposes of calculating CAF ICC Support at the individual study area level, however, the Commission should rely on each study area's actual 2011 interstate revenue requirements rather than tariff projections.

The rule requiring carriers to use tariff forecasts to determine Baseline amounts comes as a surprise. The Commission did not propose this approach in any of the notices leading up to the

[79] *Order* ¶ 892.

[80] 47 C.F.R. § 51.917(b).

Order, and carriers certainly could not have reasonably anticipated such short-term forecasts would form the basis for CAF ICC Support payments. For NECA tariff participants, use of forecasts is especially problematic. While NECA's overall tariff forecasts are reasonably accurate, there are great variations at the study area level.[81] Indeed, some companies do not prepare individual forecasts at all, and instead rely on NECA to develop them. Actual revenue requirements will, in contrast, be far more accurate and fair in establishing individual company interstate Baseline amounts.[82]

As this Rate-of-Return Baseline revenue requirement will be used for years to come to calculate individual study area CAF ICC Support amounts, the Associations request that the Commission reconsider use of tariff forecasts to establish Rate-of-Return interstate Baseline amounts for individual study areas and permit carriers to base such amounts on 2011 actual interstate revenue requirements.

The Commission should also reconsider its decision to define Fiscal Year 2011 as the period October 1, 2010 through September 30, 2011, for purposes of calculating rate-of-return carriers' base period revenues and demand.[83] To assure that base period data are fully and fairly representative of prior-year operations and provide a greater degree of certainty and closure to all

[81] Based on an analysis of differences between forecasted and actual revenue requirement data for 2010, tremendous differences exist in the extremes, with some study areas seeing increases up to 120 percent from their forecast and some with decreases as low as 98 percent. In the 2010 data, there were 356 study areas that experienced increases and 320 study areas that experienced decreases, with an average increase of 8 percent and an average decrease of 6 percent.

[82] The Associations have previously explained the degree to which actual cost studies are subject to review and verification by independent auditors, NECA review procedures, state regulators and other entities. *E.g., Rural Associations April 18 Comments* at 29, note 62; *Rural Associations July 12 Comments* at 62. Concerns that cost studies might be manipulated in some way are thus without foundation.

[83] 47 C.F.R. § 51.903(e).

parties, the Commission should consider instead establishing the period July 1, 2010 through June 30, 2011 as the Fiscal Year under section 51.903 of the rules.

2. Inclusion of Tandem/Transit Costs in Reciprocal Compensation Calculations.

Section 51.701(a) specifies the term "reciprocal compensation" includes charges for both transport and termination of non-access telecommunications traffic. Section 51.701(c) defines transport as "the transmission *and any necessary tandem switching* of Non-Access Telecommunications Traffic subject to section 251(b)(5) . . . ." Section 51.709 establishes the rate structure for transport and termination for non-access reciprocal compensation, but specifies that the rate for transmission facilities dedicated non-access traffic "shall recover only the costs of the proportion of that trunk capacity used by an interconnecting carrier to send non-access traffic that will terminate on the providing carrier's network."[84]

To resolve this apparent inconsistency, the Associations request revision of these rules or clarification that the reference to the definition of transmission facilities in section 51.709(b) includes costs of any necessary tandem switched transport in the calculation of reciprocal compensation for purposes of computing CAF ICC Support.[85]

C. Identification of "Toll" VoIP Traffic.

The *Order* specifies that the default compensation rate for "toll" traffic exchanged between providers of Voice over Internet Protocol services and the public switched telephone

[84] 47 C.F.R. § 51.709(b)

[85] Proposed ICC rules submitted by the Associations prior to adoption of the *Order* defined net reciprocal compensation revenues as "the net difference between reciprocal compensation amounts received by the carrier from other carriers or service providers (including payments for transit service) and amounts paid by the carrier to other carriers or service providers (including payments for transit service) pursuant to agreements established under Part 51 of this Chapter." Letter from Michael R. Romano, NTCA, to Marlene H. Dortch, FCC, WC Docket No. 10-90 Attach. at 24 (filed Oct. 17, 2011).

network (VoIP-PSTN traffic) will be a carrier's interstate access rate, while applicable reciprocal compensation rates apply to other VoIP-PSTN traffic.[86] Local exchange carriers (LECs) are permitted to tariff default charges for toll VoIP-PSTN traffic in relevant federal and state tariffs in the absence of an agreement for different intercarrier compensation.[87]

Clarification is required regarding the distinction between "local" and "toll" VoIP. The Act defines toll calls as those "for which there is made a separate charge not included in contracts with subscribers for exchange service."[88] It is not clear how this definition applies in the context of VoIP or other "all distance" calling plans that do not include a separate charge for toll service. Consistent with current practice for traditional calling services, the Associations request clarification that state defined local calling areas, in combination with originating and terminating telephone numbers, will be used to determine whether particular VoIP calls should be considered local or toll.

The Associations further request clarification as to whether originating interstate access rates must be applied to intrastate "toll" calls originating on the PSTN and terminating to a VoIP customer. Inasmuch as originating carriers have no way of knowing whether particular numbers are associated with VoIP lines on the distant terminating end, it does not appear possible to apply a differential rate to such calls. To the extent the *Order* can be read to require originating carriers to bill such calls at interstate access rates, notwithstanding that signaling data indicates

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[86] *Order* ¶ 944.

[87] *Id.*

[88] 47 U.S.C.§ 153(55).

such calls are intrastate toll, the Associations request the Commission reconsider this requirement and confirm that normal billing rules apply.[89]

D. Call Signaling Rules for VoIP Traffic.

The *Order* extends the Commission's call signaling rules to interconnected VoIP service providers, requiring them to transmit the telephone number of the calling party for all traffic they originate that is destined for the PSTN.[90] Intermediate providers in a call path must pass, unaltered, signaling information they receive indicating the telephone number, or billing number if different, of the calling party.[91]

ICC obligations under the *Order*, however, apply to all VoIP-PSTN traffic, which is defined as "traffic exchanged over PSTN facilities that originates and/or terminates in IP format" and includes voice traffic from interconnected VoIP service providers as well as providers of one-way VoIP service that allow end users to place calls to, or receive calls from the PSTN, but not both. The Commission recognized that the scope of the ICC obligations for VoIP providers adopted in the *Order* is broader than the definition of interconnected VoIP to which the call signaling obligations will apply.[92] The *FNPRM* now seeks comment (yet again) on the need for signaling rules for one-way VoIP service providers.

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[89] The Commission did not explicitly address compensation obligations for VoIP traffic exchanged prior to the *Order*'s effective date. *See Order* ¶ 945. To resolve numerous pending disputes, the Commission should reconsider this "hands off" approach and confirm that VoIP traffic exchanged prior to the *Order*'s effective date is and has always been subject to the same ICC obligations as any other switched voice traffic. *See e.g.,* Comments of NECA, NTCA, OPASTCO, WTA, ERTA, the Rural Alliance, and the Rural Broadband Alliance, WC Docket No. 10-90, *et al.* (filed Apr. 1, 2011) at 4-7.

[90] *Order* ¶ 717.

[91] *Id.* ¶ 719.

[92] *Id.* ¶ 1400.

Pending the outcome of the *FNPRM*, the Associations seek clarification and/or reconsideration that: (a) all kinds of VoIP services (not just interconnected) are subject to the call signaling rules; and (b) the rules apply to all traffic terminating to the PSTN, regardless of technology platform (e.g., softswitches). Otherwise, originating carriers can enter into arrangements with least-cost routers that employ a VoIP platform to "launder" traffic and thereby have all call signaling information stripped or altered from the call in question without consequence. This would clearly undermine, if not invalidate, the Commission's efforts to resolve phantom traffic concerns and do nothing after all to close long-standing loopholes that have led to arbitrage.

E. Application of Access Charges to IntraMTA Traffic Delivered by IXCs.

Under the Commission's "intraMTA rule" all traffic exchanged between a LEC and a CMRS provider that originates and terminates within the same MTA, as determined at the time the call is initiated, is subject to reciprocal compensation regardless of whether or not the call is, prior to termination, routed to a point located outside that MTA or outside the local calling area of the LEC.[93] The *Order* notes that there have been questions as to whether application of the intraMTA rule is feasible or applicable when CMRS calls are routed through an IXC, but asserts that many ILECs apply reciprocal compensation rates to intraMTA CMRS traffic without regard

[93] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd. 15499 (1996) ¶ 1036 (*Local Competition First Report and Order*); 47 C.F.R. § 51.701(b)(2). The definition of an MTA can be found in section 24.202(a) of the Commission's rules. 47 C.F.R. § 24.202(a).

to IXC routing.[94] The Commission accordingly declined to clarify that the intraMTA rules do not necessarily apply to such traffic.[95]

This result will create significant billing and call flow concerns. When a terminating RLEC receives intraMTA traffic routed through an IXC, there is no realistic way for the carrier to determine whether such calls are in fact CMRS-originated or whether they are inter- or intra-MTA. In addition, it should be recognized that the CMRS provider has made an affirmative decision to route calls through an IXC rather than seeking a local interconnection agreement with the LEC. Therefore the Commission should reconsider its denial of this request and clarify that such traffic is subject to access charges notwithstanding potential qualification for reciprocal compensation rates under the intraMTA rule.[96]

F. Phantom Traffic Issues.

In addressing "phantom traffic" problems, the Commission amended its call signaling rules to require all carriers and providers of interconnected VoIP service to include the calling party's telephone number in all call signaling, and required intermediate carriers to pass this signaling information, unaltered, to the next provider in a call path. However, it declined to

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[94] *Order* note 2132.

[95] The Commission relied on findings in the *Local Competition First Report and Order* to the effect that parties may calculate overall compensation amounts by extrapolating from traffic studies and samples. *Id.,* citing *Local Competition First Report and Order* ¶ 1044.

[96] Concerns also arise in connection with LEC-to-CMRS calls that terminate to numbers rated outside of the RLEC's landline local calling area. As previously explained to the Commission, RLEC switches need to be upgraded and programmed to perform several dips on each and every outbound long distance call from a landline telephone customer to determine if the call is destined for a CMRS customer and if so, if this customer is located inside the same MTA. In instances where CMRS carriers operating in the same MTA have not chosen to establish direct or indirect connections with the RLEC, such calls must often be routed through IXCs as well. *E.g.*, Letter from Michael R. Romano, NTCA, to Marlene H. Dortch, FCC, WC Docket No. 10-90 (filed Dec. 9, 2011) at 2. These issues may require substantial study by industry technical groups before workable solutions can be put in place.

require transmission of carrier identification information (CIC and/or OCN codes) in signaling data.[97] The Commission also denied requests from parties to clarify that, absent mutual agreement on factors or the provision of information that can be used to determine with reasonable accuracy the actual origination point of a call, terminating carriers may use as a default the originating and terminating telephone numbers associated with a call to determine jurisdiction for billing purposes.[98] The Commission noted in this regard that its proposed rules were not intended to affect existing agreements between service providers regarding how to jurisdictionalize traffic in the event that traditional call identifying parameters are missing.[99]

In fact, standard industry practice relies on the "telephone numbers rule" to determine the jurisdiction of calls for billing purposes.[100] The Associations accordingly request the Commission reconsider its decision and clarify that absent mutual agreement on factors or the provision of information that can be used to determine with reasonable accuracy the actual origination point of a call, terminating carriers may use as a default the originating and terminating telephone numbers associated with a call to determine jurisdiction for billing purposes.

The Associations also request reconsideration of the Commission's decision not to impose financial responsibility for traffic delivered without adequate billing information on the last carrier in the call stream sending such traffic.[101] In declining this suggestion, the Commission found that imposing upstream liability or financial responsibility on carriers

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[97] *Order* ¶ 727.

[98] *Id.* note 1212.

[99] *Id.*

[100] Even where percent interstate usage factors (PIUs) are used, carriers must still rely on calling and called telephone numbers when conducting audits of PIUs submitted by sending carriers.

[101] *Order* ¶¶ 731-732

threatens to unfairly burden tandem transit and other intermediate providers with investigative obligations. Instead, the Commission placed the responsibility and liability with the party that failed to provide the necessary information, or that stripped the call-identifying information from the traffic before handing it off.

It will be difficult, however, for terminating carriers to identify "the party that failed to provide the necessary information" because, as noted above, the Commission declined to require transmission of adequate carrier identification information in signaling data. On the other hand, upstream carriers accepting such traffic are fully aware of the identity of the financially-responsible carrier or provider. Under the Associations' proposal, the terminating carrier would be allowed to charge its highest effective rate to the service provider delivering the phantom traffic to it, when the call detail information is insufficient to bill for such calls. In turn, an intermediate provider would be able to charge that rate to the service provider that preceded it in the call path, until ultimately the carrier that improperly labeled the traffic would be required to pay for its own traffic. Apart from assuring the correct entity is actually required to pay for the services it receives, this approach will significantly reduce upward pressure on the CAF ICC Support mechanism associated with non-payments.

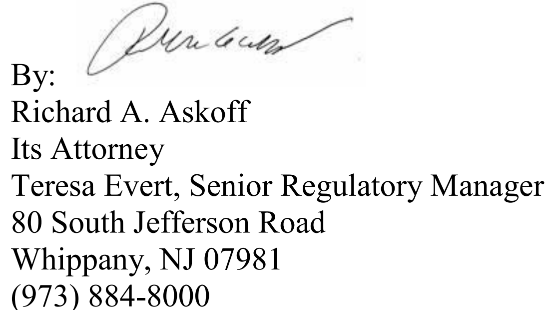
The Associations accordingly request that the Commission either require passage of all CIC, OCN, and other carrier identifying information necessary to establish with certainty the financially responsible party for a call, or allow terminating carriers to bill the carrier or provider sending the calls to them at their highest effective rate when those calls fail to carry sufficient call signaling information to allow for proper billing.

VII. CONCLUSION

For the reasons specified above the Associations seek reconsideration and/or clarification of the Commission's *Order* in the above-captioned proceeding.

Respectfully submitted,

NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.



By:
Richard A. Askoff
Its Attorney
Teresa Evert, Senior Regulatory Manager
80 South Jefferson Road
Whippany, NJ 07981
(973) 884-8000

ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES
By: /s/ Stuart Polikoff
Stuart Polikoff
Vice President – Regulatory Policy and Business Development
2020 K Street, NW, 7th Floor
Washington, DC 20006
(202) 659-5990

WESTERN TELECOMMUNICATIONS ALLIANCE
By: /s/ Derrick Owens
Derrick Owens
Director of Government Affairs
317 Massachusetts Avenue N.E., Ste. 300C
Washington, DC 20002
(202) 548-0202

By: /s/ Gerard J. Duffy
Gerard J. Duffy
Regulatory Counsel for Western Telecommunications Alliance
Blooston, Mordkofsky, Dickens, Duffy & Prendergast, LLP
2120 L Street NW (Suite 300)
Washington, DC 20037
(202) 659-0830

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