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GVNW

96-263

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January 24, 1997

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 20554

Dear Mr. Caton:

Enclosed are the original and sixteen copies of the comments of GVNW Inc./Management in response to the Commission's Public Notice in CC Docket 96-262 (Reference FCC No. 96-488) released December 24, 1996. A diskette containing the filing is also enclosed.

Also enclosed is one copy of our comments to be stamped and returned in the enclosed self addressed stamped envelope.

Any questions regarding this filing may be directed to me at (503) 624-7075.

Sincerely,

Kenneth T. Burchett

Kenneth T. Burchett
Vice President

cc: International Transcription Service
2100 M Street N.W.
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Encl.

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GVNW INC./MANAGEMENT
P.O. Box 230399 · Portland, Oregon 97281-0399 · 7125 S.W. Hampton · Portland, Oregon 97223 · (503) 624-7075 · Fax: (503) 624-7076

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

COMMENTS OF GVNW INC./MANAGEMENT

I. Introduction

GVNW Inc./Management (GVNW) is a management consulting firm which provides financial and regulatory consulting services to independent telephone companies. These comments focus primarily on the impact that the issues raised in the Notice of Proposed Rulemaking (NPRM) may have on small LECs and, ultimately, on the provision of quality universal service at affordable prices throughout rural America. As is requested in paragraph 341 that all parties clearly identify the specific portion of this NPRM to which a particular comment is responsive, we have organized these comments to follow the presentation of the NPRM. We are pleased that the Commission has recognized, in paragraph 244, "that, because of the role that access charges have played in funding and maintaining universal service, it is critical to implement changes in the access charge system together with complementary changes in the universal service system."

Summary of Comments

1. GVNW is concerned about the precedential nature of decisions in this proceeding with respect to future access charge revisions for rate of return local exchange carriers.

2. The Commission should establish a Network Ubiquity Policy Element (NUPE) to recognize the prior commitment to develop an ubiquitous telecommunications network.

3. In situations where carriers attempt to avoid resale provisions through rebundling, access charges should continue to apply.

4. Residual TIC dollars assigned to the transport category should not be phased out or eliminated until these costs have been addressed in other proceedings. Full recovery of the TIC should continue on an interim basis.

5. LECs are entitled to recover all of the difference between interstate-allocated embedded costs and forward-looking economic costs.

6. Rate of return local exchange carriers should be permitted to use any revenues received from universal service support mechanisms, in excess of the amount of cost assigned to interstate resulting from the Commission's implementation of the Joint Board recommendation, to offset all implicit and explicit universal service requirements prior to recognizing any cost reductions.

II. Access Reform for Incumbent Local Exchange Carriers

A. Application of Reforms to Price Cap Carriers and Non-Price Cap Carriers

The access charge reform portion (CC Docket No. 96-262) of this Notice of Proposed Rulemaking forms the third in the series that has been referred to as the Commission's trilogy of dockets that will significantly shape the national policy framework necessitated by the Telecommunications Act of 1996. The access reform issues addressed herein are interrelated to the universal service and local interconnection dockets. As the Commission considers access reform, it is vital to rate-of-return LECs that this deliberation include the important public policy issues surrounding the provision of "sufficient and predictable universal service mechanisms" as mandated in Section 254 (b) (5) of the Communications Act. The rules promulgated in one portion of the trilogy will impact the other portions, and vice versa. GVNW, on behalf of its client companies, has serious reservations about whether some of the decisions reached to date[1] do indeed meet the objectives that Congress intended with the passage of the communications legislation last year. For non-price cap local exchange carriers, the access charge revenue stream represents, on average, twice the percentage of its total revenues as it does for an average regional Bell Operating Company.[2] In addition to creating wholesale and retail market segments, the Interconnection Order creates arbitrage potential for competitors to rebundle elements and avoid access charges. While there is much dispute surrounding

[1] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996), petition for review pending and partial stay granted, sub. nom. Iowa Utilities Board et. al v. FCC, No. 96-3321 and consolidated cases (8th Cir., Oct. 15, 1996).

[2] RBOC average access charge 29.9% of total revenue as compared to Rural Telephone Companies average of 59.7% of total revenue, Presentation at USTA Seminar on Interconnection, September 5, 1996, Calvin S. Monson, Strategic Policy Research, Inc.

certain provisions of the pending interconnection rules, most, if not all parties, agree that wholesale price levels for incumbent local exchange carriers will not be able to sustain the implicit universal service support that has been codified into Part 69 of the Commission's Rules.

In this context, it is essential that decisions reached with respect to access reform provide for adequate and compensatory cost recovery mechanisms for non-price cap local exchange carriers. In other words, for any access charge reforms to meet with the requirements of the Communications Act, the current implicit subsidies embodied in existing access charge rates will need to be recovered, to the extent possible, through explicit means.

In paragraph 52, the Commission concludes that "we should focus our efforts here on the immediate task of reforming the access charge regime for price cap incumbent LECs. We plan to initiate a separate proceeding in 1997 to undertake comprehensive review of our regulation of rate-of-return LECs." While we understand in theory the merits of this approach, we are concerned with the precedential nature of any decisions the Commission may reach in this proceeding. In addition, our client companies have begun to receive bona fide requests for interconnection and in some cases may require some pricing flexibility in order to respond in a reasonable manner.

B. Applicability of Part 69 to Unbundled Elements

We disagree with the Commission's tentative conclusion that unbundled network elements should be excluded from the access charge regime. In situations where a carrier

attempts to avoid resale provisions through rebundling, access charges should continue to apply.

The costs related to providing interstate access services remain allocated to the interstate jurisdiction. Until a Joint Board recommends, and the Commission adopts, changes to the Part 36 separations rules, incumbent local exchange carriers should be permitted to recover the portion of these costs that are assigned to the appropriate access elements.

III. Rate Structure Modifications

A. Overview

At paragraphs 55 and 56 of the NPRM, the Commission *"tentatively concludes that several provisions in Part 69 of our rules compel incumbent LECs to impose charges for access services in a manner that does not accurately reflect the way those LECs incur the costs of providing those services. . . We tentatively conclude that, regardless of which of the approaches to access reform discussed in Section IV we choose. . . We seek through these changes to establish rate structures for interstate access services that send more accurate pricing signals to both consumers and competitors."* While the Commission notes that "rate structure revisions for non-price cap incumbent LECs will be addressed in a separate proceeding", we are concerned that due to the percentage of total company revenues related to access charges, it is necessary to address, at least briefly, the signals that access charge changes send to customers who benefit from the implicit universal service support currently included as a part of the Commission's Part 69 rules.

Today, access charges recover both the costs associated with the categories of service reflected in Part 69 of the rules, as well as the means by which to compensate LECs for the costs related to developing, maintaining, and updating the ubiquitous public switched network. If the Commission is ultimately successful in reducing access charges toward an interexchange carrier economists view of costing, an obligation still remains under the Act to provide for the remaining costs and permit the recovery for these costs of ubiquity for all existing rate-of-return LECs.

If the Commission were to change access rules without regard to the fact that the Part 36 separations rules still allocate a portion of these ubiquity costs to the interstate jurisdiction, they would not be permitting compensatory recovery to the incumbent local exchange carrier. If the cost of this ubiquity is not to be included with the other network elements, it will be necessary and appropriate to include these costs as a separate element. To this end, we have included as Appendix D proposed Part 69 rule changes related to establishing as a separate access element the cost of universal availability.

B. Common Line

GVNW is on the record in earlier proceedings with proposing to modify the current common line rate structure. We continue to support changing the recovery of the non-traffic sensitive portion of the local loop from a per-minute basis to a bulk-billed basis, assessed to and paid by interexchange carriers.

We do not agree, however, with the proposal to increase the subscriber line charge cap for secondary residential lines and for multiline businesses in rural areas. We submit for the record the data found in Exhibit A for 79 local exchange carriers as to the impact of such a proposal. It is plain to see such a proposal would have a deleterious impact on rural customers, and create unwarranted administrative burdens on local exchange carriers relative to the benefit of adopting such a proposal. The data found in Exhibit A clearly indicates that a three year transition to removing the cap would be insufficient in a number of cases.

C. Local Switching

GVNW recommends that the current per-minute structure be retained, as discussed in Paragraph 79, until a complete review of access charges for non-price cap companies is conducted and any proposed separations changes are implemented.

D. Transport

At paragraph 94, the Commission includes a discussion that initial tandem-switched transport rates were presumed reasonable if set as a weighted average of the per-minute cost of DS3 and DS1 rates calculated using 9000 minutes of use per month. For many non-price cap companies, the actual minutes traversing the tandem circuits is significantly below this level.

E. Local Exchange Carriers are Entitled to Recovery of Costs Assigned to the Transport Interconnection Charge (TIC)

Local exchange carriers should be permitted to realize a full recovery of the costs that have been allocated to the interstate jurisdiction through the application of the Commission's Part 36 Separation Rules and to the local transport element through the proper application of the current Part 69 Access Rules.

The Transport Interconnection Charge (TIC) was created as a part of the interim transport rate structure in the Commission's proceeding designated as CC Docket No. 91-213. Under these rules, switched transport rates were based in large part on the special access rates applicable at that time (e.g., 1993 rates and 1992 demand). The TIC represented the residual amount that enabled a LEC to recover the same level of total transport element revenue under the revised structure as was received under the prior rules.

GVNW recommends that the Commission review the TIC issue for non-price cap companies as having two piece parts. The first being the costs of providing service related to transport, tandem switching and trunking that could and should be reassigned to different, and in this competitive access environment, more appropriate elements. The second piece, that related to previous public policy decisions, should be permitted recovery via a new public policy recovery mechanism.

Joint Board action would be required to implement the changes discussed above for the service related cost components. As there is an inherent regulatory lag in this process, GVNW recommends that these costs be recovered in a different manner during

the pendancy of these rulemakings. Until the required separations reform and access reform for non-price cap companies is completed, the TIC costs should be bulk-billed to interexchange carriers. We recommend similar recovery for the residual public policy portion as well.

IV. Approaches to Access Reform and Deregulation

In paragraph 143, the Commission, in discussing approaches to access reform, states in part:" ... *it requires the Commission to make detailed determinations of appropriate price levels . . . in the event an incumbent LEC can show its embedded costs are significantly higher than its forward-looking costs, the Commission would be required to determine how much of the difference incumbent LECs should be given a reasonable opportunity to recover and the method for that recovery.*" As we state throughout these comments, LECs should be afforded the opportunity to recover this entire difference, in a competitively neutral manner.

V. Market-Based and VI. Prescriptive Approach to Access Reform

A. Introduction

At paragraph 218, the Commission notes that "*parties might argue that, at best, competition will emerge unevenly among geographic areas, services, and customer classes, and argue ... a prescriptive approach, should be followed.*" We question whether

mandated reductions to access mechanisms, prior to the rational competitive entry, was the Congressional intent for rural areas of the country.

While the Commission contends that utilizing interstate access rates as a mechanism to subsidize rates for other services is not sustainable in a competitive marketplace, it is imprudent public policy to disregard the past commitments made to those carriers that have assisted in development of an ubiquitous public switched network. One of GVNW's concerns with a prescriptive approach (e.g., downward adjustments) to altering access charge structures is evidenced in recent interexchange carrier responses to access rate reductions from price cap LECs. Despite continued significant reductions on an annual basis, the three largest IXCs (AT&T, MCI, and Sprint) have raised their rates, in tandem, six times between 1992 and the present. We do not believe that it was the intent of Congress to enrich large Fortune 100 corporations to the detriment of providing universal service to rural Americans.

B. Goal of Prescriptive Access Reform

These same interexchange carriers (AT&T, MCI, and Sprint) mentioned above have also submitted computer models designed to calculate forward-looking economic cost, as the Commission notes at paragraph 220. We have detailed some of the shortcomings of these submissions in Appendix B, Summary of Observations and Issues on Cost Proxy Models. This data was also submitted as Appendix B in our filing in CC Docket No. 96-45.

Additionally, we have included as Appendix C materials that GVNW presented at the January 14 and 15, 1997, Commission workshops on proxy costing models by GVNW's Mr. Robert C. Schoonmaker and Ms. Lisa K. Hanselman.

Other parties agree with the conclusions that we offer in these appendices. For example, Mr. Taylor of NERA documents that these models are inaccurate and have been discredited in nearly every state.[3] The Joint Board did not adopt a specific model in their recent Universal Service order.

In the recent FCC Staff Position paper entitled The Use of Computer Models for Estimating Forward-Looking Economic Costs, the staff asserts at paragraph 11 that "*Proxy models may be utilized for multiple regulatory objectives, such as in a prescriptive approach to access reform, determining levels of universal service support in high cost areas, and the pricing of unbundled network elements. It is not clear from our analysis to date whether a single proxy model, or combination of models, can or should be used to achieve all of these objectives.*"

We believe that it would be problematic, if not impossible, to select a single model for all pricing needs for incumbent local exchange carriers due to one irrefutable fact of economics: **If all of the firm's services were sold at TSLRIC/TELRIC, the firm would not recover all of its costs**. In the case of rural companies, this would result in the decline and eventual demise of universal communications service to rural citizens. This is contrary to Section 252 (d) (1) (B) of the Communications Act that permits the incumbent LEC to recover its costs with pricing levels that include a **reasonable profit**.

[3] William E. Taylor, "Not the Real McCoy: A Compendium of Problems with the Hatfield Model", USTA Ex Parte, CC Docket No. 96-45, October 16, 1996.

VII. Transition Issues

A. Universal Service Joint Board Recommended Decision

In paragraph 246, the Commission requests comment on how rate-of-return incumbent LECs should treat revenues received from any new universal service support mechanisms to the extent allocated to the interstate jurisdiction.

GVNW recommends that rate-of-return incumbent LECs be permitted to use any new funding amounts to first offset all existing implicit and explicit universal service requirements before reducing any other service costs. It is important to note, however, that the Joint Board recommendation only addressed three support mechanisms for rural LECs: Long Term Support (LTS), Weighted DEM, and USF for high loop costs. It is not clear where the additional support is going to come from unless the FCC goes beyond these three mechanisms in adopting universal service rules.

B. 2. Recovery of Remaining Interstate-Allocated Embedded Costs

At paragraphs 256-259, the Commission has invited parties to comment on several key recovery issues with respect to independent local exchange carriers. Incumbent LECs are indeed entitled and should be permitted an opportunity to recover ALL of the difference between interstate-allocated embedded costs and forward-looking economic costs that could be created by access reform proposals such as those discussed in Sections V and VI.

Changes to access rules that impede recovery would be unconstitutional

The unrecovered embedded costs of investment in a company's network facilities are real costs that will continue to be borne by the LECs. If LECs are not permitted to recover these costs, such actions would be deemed confiscatory and would be subject to review under the Takings Clause. Established precedent in this regard may be found in Duquesne Light Co. v. Barasch, 488 U.S. 299, 308-10 (1989); and FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944). Any changes to access rates that result in revenues that do not recover total costs associated with past investment decisions reviewed by regulators do not comport to the intent of the Communications Act of 1996. Any Commission decisions to prevent a LEC from a compensatory return would violate the LECs due process under the law and undermine its legitimate, investment-backed expectations. Such interference with (LEC) property rights in a manner that undermines such expectations constitutes a taking as found in Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

The legal basis for permitting such recovery is the same under either a market-based or prescriptive approach to access reform.

No record evidence exists as to Embedded Cost Inefficiencies

At paragraph 257, comments are sought as to whether any embedded costs resulting from inefficiency should be denied recovery. There is no evidence on the record

to indicate that ILEC investment has been inefficient. Embedded investments have been reviewed and scrutinized by both the federal and the various state commissions. It would be inequitable to review such investments after the fact and reach a different conclusion without a full and fair hearing. In the case of investments required to provide equal access or provide 800 databases, Commission action has required investment to be deployed. Until the record indicates otherwise, the Commission should establish a rebuttable presumption that embedded costs are recoverable.

A dual responsibility exists between the federal regulators and state regulators to ensure recovery of embedded investments

While the states will obviously need to be involved in ensuring that embedded costs that are jurisdictionally allocated to intrastate be permitted recovery, the FCC cannot shirk their responsibility to provide for adequate interstate recovery mechanisms with an argument of conserving industry resources.

While Congress intended to promote competitive entry to telecommunications markets with the passage of the Telecommunications Act of 1996, there was no intent to deny incumbent local exchange carriers the ability to recover costs incurred in good faith under a six decade long social contract.

VIII. Other Issues

A. Regulation of Terminating Access

GVNW is opposed to any access charge policy changes which shifts the burden of terminating access charges directly to the end-user customer. We believe that the rate rebalancing that will occur over the next 3-5 years will shift costs to rural customers, without considering the potential impact of terminating access.

B. Treatment of Interstate Information Services

GVNW's client companies support the continued growth of information service providers and the benefits that they provide to end user customers. Many of our client companies themselves, or through affiliates, provide Internet or other information services. The issue of cost recovery from information service providers will not go away. The flat rates being charged for ostensibly usage sensitive services are contributing to network congestion in even some rural markets and raise concerns for local exchange carriers.

Current rules create an implicit subsidy for interstate information service providers, in the sense that to some degree they are not paying for the costs they incur and this burden is thus shifted to other network users. If the Commission intends to eliminate many of the existing implicit subsidies in order to comport to the Communications Act, it does not seem to make sense to ignore an implicit subsidy in this arena.

CONCLUSION

It appears clear that a primary objective of the Commission in these proceedings is to initiate significant reductions in local exchange carrier access rate levels. The Commission should keep in mind as it considers proxies as a vehicle to this end why access rates include implicit subsidies. At least for rate of return LECs, access rate levels prevailing today are reflective of the costs attributable to providing UBIQUITOUS high quality services. If one is able to look past much of the IXC rhetoric, the simple fact remains that small LECs are efficient operations, providing universal service where others chose not to serve. To maintain this Congressionally-mandated level of universal service, any reductions in access pricing must be accompanied by an assured level of sufficient and predictable support from explicit funding sources. It is only through providing this sufficient support that the Commission will enable the continuation of affordable telecommunications service to rural Americans.

Respectfully submitted

GVNW Inc./Management

By: Kenneth T. Burchett

Kenneth T. Burchett
Vice President
7125 S.W. Hampton
Portland, Oregon 97223

Price out of Multiline Business and Second Line Residence SLCs (NPRM PARAGRAPH 65)

	Company Name	NECA Code	12/96 Loops	Interstate Common Line	Com. Line Cost per Loop	Multi Line & Sec. Line SLC
1	Hardy	200259	2598	$590,269	$227	$18.93
2	EATEL	270429	31267	$3,420,013	$109	$9.12
3	Cass County	340984	3104	$273,034	$88	$7.33
4	Egyptian	341003	2846	$358,305	$126	$10.49
5	C-R Telephone	341009	958	$171,503	$179	$14.92
6	Shawnee	341025	4755	$390,189	$82	$6.84
7	Harrisonville	341026	17131	$1,891,282	$110	$9.20
8	Home	341032	915	$267,799	$293	$24.39
9	Madison	341049	1424	$293,814	$206	$17.19
10	Montrose Mutual	341058	1478	$116,060	$79	$6.54
11	Moultrie	341060	786	$175,707	$224	$18.63
12	Ayrshire	351105	364	$44,680	$123	$10.23
13	Webb Dickens	351327	441	$33,619	$76	$6.35
14	Grand River (Iowa)	351888	6078	$468,771	$77	$6.43
15	West River (WRT & WRC)	381637	15439	$1,721,526	$112	$9.29
16	S&A	411829	866	$269,099	$311	$25.89
17	Citizens	421865	3895	$430,872	$111	$9.22
18	Grand River (Mo.)	421888	14200	$1,324,479	$93	$7.77
19	Kingdom	421901	4161	$668,696	$161	$13.39
20	Dell Telephone (Tx)	442066	718	$563,596	$785	$65.41
21	Midvale - Arizona	452226	493	$121,550	$247	$20.55
22	Table Top	453334	4471	$624,543	$140	$11.64
23	Peetz	462196	208	$159,187	$765	$63.78
24	Rico	462201	150	$63,723	$425	$35.40
25	Albion	472213	1154	$291,459	$253	$21.05
26	Cambridge	472215	1085	$217,770	$201	$16.73
27	Filer - Idaho	472220	2080	$130,617	$63	$5.23
28	Midvale - Idaho	472226	582	$214,092	$368	$30.65
29	Rockland	472232	309	$112,924	$365	$30.45
30	Rural - Idaho	472233	520	$131,166	$252	$21.02
31	Blackfoot	482235	7300	$1,121,739	$154	$12.81
32	Interbel	482242	1500	$562,503	$375	$31.25
33	Nemont	482247	13555	$3,036,401	$224	$18.67
34	Range (Mont)	482251	3788	$931,689	$246	$20.50
35	Southern Montana	482254	916	$205,288	$224	$18.68

Price out of Multiline Business and Second Line Residence SLCs (NPRM PARAGRAPH 65)

	Company Name	NECA Code	12/96 Loops	Interstate Common Line	Com. Line Cost per Loop	Multi Line & Sec. Line SLC
36	Triangle	482257	9700	$885,468	$91	$7.61
37	Clark Fork	483308	7000	$1,279,400	$183	$15.23
38	Central Montana	483310	7600	$1,379,733	$182	$15.13
39	Dell Telephone (NM)	492066	425	$239,939	$565	$47.05
40	Baca	492259	706	$325,482	$461	$38.42
41	Roosevelt	492272	2148	$399,913	$186	$15.51
42	Central Utah	502277	1322	$161,989	$123	$10.21
43	Emery	502278	4486	$338,102	$75	$6.28
44	Bear Lake	503032	690	$95,413	$138	$11.52
45	Range Wy.	512251	17200	$2,533,832	$147	$12.28
46	Chugwater	512289	266	$41,455	$156	$12.99
47	Dubois	512291	2083	$1,289,052	$619	$51.57
48	Ellensburg	522412	19796	$1,390,858	$70	$5.85
49	Midvale - Oregon	532226	225	$48,675	$216	$18.03
50	Beaver Creek	532359	4386	$532,520	$121	$10.12
51	Canby	532362	10048	$560,781	$56	$4.65
52	Clear Creek	532363	3565	$458,745	$129	$10.72
53	Colton	532364	1184	$290,675	$246	$20.46
54	Eagle	532369	421	$99,945	$237	$19.78
55	Cascade	532371	9129	$875,175	$96	$7.99
56	Helix	532376	278	$192,736	$693	$57.77
57	Trans-Cascades	532378	158	$200,931	$1,272	$105.98
58	Molalla	532383	5544	$1,176,072	$212	$17.68
59	Monitor	532384	659	$96,509	$146	$12.20
60	Nehalem	532387	2870	$185,866	$65	$5.40
61	North State	532388	514	$88,904	$173	$14.41
62	Oregon Tel	532389	1772	$219,104	$124	$10.30
63	Oregon-Idaho	532390	738	$503,906	$683	$56.90
64	Pine	532392	821	$215,373	$262	$21.86
65	Pioneer	532393	14105	$1,433,958	$102	$8.47
66	The Ponderosa	542332	8194	$2,083,935	$254	$21.19
67	Siskiyou	542339	4560	$1,060,187	$232	$19.37
68	Rural - Nevada	552233	635	$183,725	$289	$24.11
69	Churchill	552349	11700	$1,333,409	$114	$9.50
70	Lincoln County	552351	2060	$214,904	$104	$8.69

Price out of Multiline Business and Second Line Residence SLCs (NPRM PARAGRAPH 65)

	Company Name	NECA Code	12/96 Loops	Interstate Common Line	Com. Line Cost per Loop	Multi Line & Sec. Line SLC
71	Rio Virgin	552356	4678	$651,978	$139	$11.61
72	Humboldt	553304	627	$182,235	$291	$24.22
73	Arctic Slope	613001	2090	$600,271	$287	$23.93
74	Bristol Bay	613003	1799	$301,868	$168	$13.98
75	Bush Tel	613004	790	$552,230	$699	$58.25
76	Cordova	613007	2100	$251,645	$120	$9.99
77	Interior	613011	4464	$1,172,475	$263	$21.89
78	Mukluk	613016	1047	$317,449	$303	$25.27
79	OTZ	613019	2848	$445,537	$156	$13.04

APPENDIX B

SUMMARY OF OBSERVATIONS AND ISSUES ON COST PROXY MODELS

Introduction

The Federal-State Joint Board seeks comment on the Recommended Decision, released November 8, 1996. GVNW has begun a working analysis of cost proxy models available to date These include Benchmark II, Hatfield Model 2 2, Version 2 and the Cost Proxy Model Our analysis is moving forward on four fronts, (1) an analysis of the models against defined criteria, (2) the appropriateness of the model's current underlying engineering decisions in a small company environment, (3) the relevance of current inputs applied to a small company environment, and (4) the impact of model results on funding levels for the provisioning of universal service for small companies Although our evaluation has just begun, this Appendix addresses initial observations that have been made to date. Table 1 highlights several of the issues expressed within

A. Defined Criteria

Model development must be based on a well defined set of guidelines and underlying principles. Paragraph 277 of the Joint Board Recommendation sets forth criteria by which a reasonable evaluation of any proxy model to produce forward-looking costs shall be conducted Absent from that list are two primary principles, evaluating the models for competitive neutrality and conformance to TELRIC/TSLRIC methodology. Regarding competitive neutrality, the Joint Board states, "Proxy models, because they are not based on any individual companys' costs, provide a

TABLE 1

HIGHLIGHTS OF MODEL ISSUES

Category	*Issue*
1. General Concerns	--Guidelines for model development require clarification. --Lack of criteria defining "competitively neutral." --Lack of criteria for the use of "least-cost."
2. Engineering Concerns	--Underground and buried cable must be treated separately --Mapping of wire centers, census blocks and demand should be more thoroughly described --Joint ownership of plant is not considered properly. --Possible overdeployment of digital loop carrier by these models --"Desert Start" approach results in unrealistic network engineering decisions. --Outside plant elements are not always considered, i.e. manholes, poles, gauge of wire, bridge tap, loading, etc. --Various network elements are treated differently from one model to the next. --Interoffice facilities network elements are not adequately addressed. --Switching elements are not adequately addressed. --Support networks are not addressed properly (signaling, SS7 and synchronization). --Projecting and provisioning of business lines, residence lines and special access lines requires further review. --Placement of remote switches is not modeled correctly. --Costs for survivability are not considered. --Proper size of study area requires further consideration. --Traffic issues need to be considered. --Alternate technology decisions should be incorporated. --Maintaining network plant and capacity efficiency.
3. Input Considerations	--Inputs are not adequately supported. --Wide degree of variation between models for similar inputs need to be aligned. --Capital investments and technology are considered forward looking, whereas expense inputs are historical.
4. Verification of Model Results	--Application and results of Part 32, 36 and 69 should be reviewed with regard to the proxy models.

competitively neutral estimate of the cost of providing supported services."[1] Effective competitive entry objectives of CC 96-325 rely on the employment of forward-looking, long-term incremental costs with key assumptions including the cost of money, economic life, plant replacement cost and cable/wire fill factors. Docket 96-325 states, "We noted, however, that there was a lack of general agreement on the specifics of methodology for deriving prices based on LRIC or total service long-run incremental cost (TSLRIC)." The analysis of the models relevant to compliance with TELRIC/TSLRIC methodology is flawed without consensus of what the methodology is. By what measure, then, will costs be considered technology neutral? An agreeable foundation is essential to develop a cost proxy model that produces competitively neutral results.

The Hatfield documentation states that pricing for many central office elements is from publicly available studies on component pricing. However, *what* publicly available data is not disclosed; publicly available doesn't necessarily mean competitively neutral. Switch investment estimates are from "typical per-line prices paid by BOCs, GTE and other independents."[2] "Loop cable pricing information is based on Hatfield's best estimate as default values for cable investment per foot and cable fill factors obtained from discussions with subject matter experts."[3] Tandem switching investments are based on AT&T assumptions contained in an AT&T report on interexchange capacity expansion costs. Wire center investments consider internal assumptions for room sizes required to house a switch. These assumptions do not consider the vast differences between building requirements for a Bell Operating Company and an Independent Telco. Hatfield and BCM base digital loop carrier investment primarily on SLC 2000 (a Lucent Technology Product) or AFC (Advanced Fiber Communications) also not representative of the small

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[1] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 276.
[2] Model Description, Hatfield Model, Version 2.2, Release 2, page 24
[3] Model Description, Hatfield Model, Version 2.2, Release 2, page 17

client community. Expense inputs are averaged from ARMIS reports which a large portion of the independent community does not participate in. The result is inappropriate weight factors which are based on large company conditions.

The Benchmark II (BCM) does not specify where the investment inputs are from. Structure and placement costs are stated to be "based on a national average of available contractor prices for that activity."[4] Switch investments are stated as "calculated using generic digital switch investments for five sizes of switches."[5] These statements do not clarify whether the resulting inputs reflect investment numbers representative of small telephony providers who may average less than 1,000 lines overall. Until one understands the basis of an input, one cannot change it. The BCM also utilizes ARMIS data to develop expenses. "Using national 1995 ARMIS data the historical booked expenses were developed."[6]

The Cost Proxy Model (CPM), Version 1.0 states that pricing inputs reflect proprietary PacBell inputs which are not disclosed. The pricing inputs, therefore, could not be evaluated from a small company perspective--a violation of the criteria that all underlying data, formulae and computations be available to interested parties. The CPM model also utilizes national 1995 ARMIS data to represent expenses.

The evidence is clear that current pricing assumptions *cannot* be assumed to be applicable to a small telephone Company. Nor can it be assumed that pricing assumptions are *not* based on any individual company's costs without specific evaluation of the supporting data that underlies the assumptions. Going forward without such evaluation may detrimentally impact a small telephony provider's ability to continue operations in the future.

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[4]Benchmark Cost Model 2 Methodology, page 16-17
[5]Benchmark Cost Model 2 Methodology, page 17
[6]Benchmark Cost Model 2, Methodology, page 18

The Recommendation also states that, "Technology assumed in the model should be the least-cost, most efficient and reasonable technology for providing the supported services..."[7] Considering the telephone company's position, the least-cost, most efficient technology may not be appropriate for industry players that must select a more expensive technology solution due to provisioning, maintenance or technical constraints of their current network. From the perspective of the supplier, however, least-cost may imply pricing bounded by an upper and lower limit. Thus, manufacturer's who may have formerly successfully entered the telecommunications industry with a market strategy other than price, (e.g. on the basis of technology or quality) may now be blocked from entry because they aren't strategically positioned to compete on price. If the entry of a manufacturer, who could have otherwise successfully competed in the telecommunications industry, is blocked, then isn't the spirit of the Modification of Final Judgment also, in part, dishonored? The parameters of "least-cost" technology solution must be evaluated on the basis that it supports the ability to maintain and provision the network, that it supports a clearly defined set of services and that it supports open competition via pricing levels that allow a majority of suppliers to participate.

Paragraph 277(7) states, "all underlying data, formulae, computations, and software associated with the model should be available to all interested parties for review and comment."[8] All three of the models fail to meet this criteria to one degree or another. The CPM model fails because all the underlying data is considered proprietary although its developers have been the most cooperative in terms of communicating information about the algorithms and results. Where the BCM model was perhaps the most user friendly in terms of running and evaluating data, the basis for many of the models input assumptions are unclear. The Hatfield model was the most difficult to run or evaluate. This model is

[7] CC Docket No. 96-45 Released November 8, 1996 at Paragraph 277 (1).
[8] CC Docket 96-45 Paragraph 277, page 147-148