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

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
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
	)	
End User Common Line Charges	)	CC Docket No. 95-72
	)	

JOINT EMERGENCY MOTION FOR PARTIAL STAY OF
THE RURAL TELEPHONE COMPANIES

THE RURAL TELEPHONE COMPANIES

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SUMMARY

The Rural Telephone Companies respectfully move for a partial stay of the Commission's Report and Order and Orders on Reconsideration in the above-captioned proceedings. In particular, the Rural Telephone Companies seek a stay of the portions of those decisions which would (i) make universal service support mechanisms and the recovery of local switching costs through Dial Equipment Minutes ("DEM") weighting separations rules portable; (ii) treat DEM weighting separations rules as a per line "subsidy" borne by all Universal Service Fund ("USF") contributors, rather than solely by interexchange carriers ("IXCs"); and (iii) arbitrarily cap the amount of corporate operations expenses that can be recovered through the high cost loop fund.

The Motion satisfies all four requirements for grant of a stay. First, there is a strong likelihood that the Rural Telephone Companies will prevail on the merits of their appeal. Enforcement of the USF Order, the USF Recon. Order and the Access Charge Reform Recon. Order will result in an illegal "taking" of the Rural Telephone Companies' property without just compensation in violation of the Fifth Amendment to the U.S. Constitution. Moreover, these Commission decisions are inconsistent with the USF principles described in Sections 254(b) and 254(e) of the Communications Act, as amended (the "Act"),[1] and are therefore arbitrary and capricious in violation of the Administrative Procedure Act ("APA").[2]

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[1] 47 U.S.C. §§ 254(b) and (e).

[2] See 5 U.S.C. § 706.

Second, if the stay is not granted, the Rural Telephone Companies will suffer irreparable harm. Enforcement of the provisions in question will result in the permanent loss of customers and customer goodwill, and damage to the reputation of the Rural Telephone Companies. In addition, the Rural Telephone Companies will be denied a reasonable opportunity to recover a fair rate of return on their interstate investment, in contravention of their Fifth Amendment rights. This, in turn, will preclude the further infrastructure investment needed to participate in competitive bidding for the discounted USF services to be provided to schools and libraries, which are currently some of the Rural Telephone Companies largest customers. The Rural Telephone Companies have no practical ability to recover those financial losses or regain those customers after the competitive bidding is over. Finally, the Rural Telephone Companies will be hampered in their ability to negotiate fair interconnection agreements, since the expectations of CLEC negotiators and state arbitrators will be skewed by the new USF rules.

Third, the stay requested herein would not substantially harm any other party since it would preserve the status quo and would not prevent CLECs from receiving USF support for their own investments in infrastructure under the current USF rules. Finally, grant of the requested stay would serve the public interest by ensuring that rural customers receive state-of-the-art telecommunications services at affordable rates, and by ensuring that the Commission acts in a manner which is constitutional and in line with stated agency and Congressional policy.

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	)	

TO: The Commission

JOINT EMERGENCY MOTION FOR PARTIAL STAY OF THE RURAL TELEPHONE COMPANIES

The Rural Telephone Companies,[3] by their attorneys and pursuant to §§ 1.43 and 1.44(e) of the Commission's rules, respectfully move for a partial stay of implementation of the Commission's Report and Order[4] and the Orders on Reconsideration[5] in the above-captioned

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[3] The Rural Telephone Companies are listed in Exhibit 1.

[4] Federal-State Joint Board on Universal Service, Report and Order, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997) ("USF Order"); See 62 Fed Reg. 32862 (June 17, 1997).

[5] Federal-State Joint Board on Universal Service, Order on Reconsideration, CC Docket No. 96-45, FCC 97-246 (rel. July 10, 1997) ("USF Recon. Order"); Access Charge

(continued...)

proceedings. Specifically, the Rural Telephone Companies seek a stay of the portions of those decisions which would (1) make universal service support mechanisms and the recovery of local switching costs through Dial Equipment Minutes ("DEM") weighting separations rules portable; (2) treat DEM weighting separations rules as a per line "subsidy" borne by all Universal Service Fund ("USF") contributors, rather than solely by interexchange carriers ("IXCs"); and (3) arbitrarily cap the amount of corporate operations expenses that can be recovered through the high cost loop fund.

I. INTRODUCTION

The Rural Telephone Companies are a group of incumbent local exchange carriers ("ILECs") operating separately as rate-of-return carriers either based on their own costs or through National Exchange Carrier Association, Inc., ("NECA") developed average schedule formulas. The Rural Telephone Companies are filing with the Commission, simultaneously with this Motion, a Petition for Reconsideration of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order.

The companies represented herein serve predominantly rural areas, including small villages and towns, sparsely populated farming communities and/or isolated mountainous areas with difficult terrain. These characteristics tend to increase the Rural Telephone Companies' costs of doing business. Despite these high costs the Rural Telephone Companies have managed to build telephone networks providing state-of-the-art services at affordable rates. This level of

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[5] (...continued)
Reform, Order on Reconsideration, CC Docket 96-262, FCC 97-247 (rel. July 10, 1997) ("Access Charge Reform Recon. Order").

service has been made possible, in part through existing universal service support mechanisms, the recovery of local switching investment through the DEM weighting separations rules, and is also due in large measure to the tireless dedication of the Rural Telephone Companies to effectively serve their communities.

The USF Order and the recently released USF Recon. Order place an arbitrary cap on the amount of corporate operations expenses that can be recovered from high cost loop support, and makes USF support and the recovery of local switching costs through DEM weighting portable to competitive local exchange carriers (" CLECs"). This will result in an illegal "taking" of the Rural Telephone Companies' property without just compensation in violation of the Fifth Amendment to the U.S. Constitution.[6] Moreover, the Commission's decision is inconsistent with the USF principles described in Sections 254(b) and 254(e) of the Communications Act, as amended (the "Act").[7] The provisions, therefore, are arbitrary and capricious and must be stayed pursuant to Section 706 of the Administrative Procedure Act ("APA").[8]

The USF Order also modifies existing jurisdictional separations rules, removing current DEM weighting for small ILECs and replaces that cost recovery mechanism with so-called "local switching support" paid from a new USF mechanism.[9] The Access Charge Reform Recon. Order requires the Rural Telephone Companies to reduce the local switching rates they charge to interexchange carriers effective January 1, 1998 to reflect this change to the DEM

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6 U.S. Const. amend. V

7 47 U.S.C. §§ 254(b) and (e).

8 See 5 U.S.C. § 706(2)(A).

9 See 47 C.F.R. §54.301.

weighting separations rules. Thus, the Commission's local switching rules incorrectly treat DEM weighting as a "subsidy" to be borne by all USF contributors, an allocation which is inconsistent with long standing principles of cost causation.

Enforcement of the aspects of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order, requiring portability of USF support and the recovery of local switching costs through DEM weighting, the treatment of the DEM weighting separations rules as a subsidy, and the arbitrary cap on the recovery of corporate operations expenses would irreparably harm the Rural Telephone Companies by (i) causing permanent loss of customer goodwill and reputation, and a permanently eroded customer base; (ii) causing unrecoverable economic losses resulting from denying them a just and reasonable return on their investment in contravention of their Fifth Amendment rights; and (iii) significantly hampering their ability to conduct interconnection negotiations. Accordingly, these provisions should be stayed.

II. ARGUMENT

The Commission evaluates motions for stay under well-established principles. To support a stay, a petitioner must demonstrate: (i) that it is likely to prevail on the merits; (ii) that it will suffer irreparable harm if a stay is not granted; (iii) that other interested parties will not be harmed if a stay is granted; and (iv) that the public interest favors grant of a stay.[10]

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[10] Washington Metropolitan Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d 841, 843 (D.C. Cir. 1977); Virginia Petroleum Jobbers Ass'n v. FPC, 259 F.2d 921, 925 (D.C. Cir. 1958).

In evaluating the likelihood of success on appeal, a petitioner is not required to establish with absolute certainty that it will succeed.[11] Moreover, the courts have recognized that an agency considering a request to stay its own order need not confess error to grant the requested relief. To the contrary, it is enough that the agency recognize that it has ruled on concededly difficult issues and that the equities favor relief. As the D.C. Circuit explained in Holiday Tours, supra:

> Prior recourse to the initial decision maker would hardly be required as a general matter if it could properly grant interim relief only on a prediction that it has rendered an erroneous decision. What is fairly contemplated is that tribunals may properly stay their own orders when they have ruled on an admittedly difficult legal question and when the equities of the case suggest that the status quo should be maintained.[12]

Once a party has established that it has a reasonable likelihood of succeeding on the merits, courts employ their traditional equitable powers in assessing whether, on balance, a stay is warranted. The stronger the case as to the likelihood of success on the merits, the less powerful the showing of irreparable harm needs to be, and vice versa.[13] As demonstrated below, the Rural Telephone Companies' Motion for Stay satisfies the requirements for grant of a stay.

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[11] Population Inst. v. McPherson, 797 F.2d 1062, 1078 (D.C. Cir. 1986).

[12] 559 F.2d at 844-45.

[13] See, State of Ohio ex rel. Celebreeze v. NRC, 812 F.2d 288, 290 (6th Cir. 1987); see also, Population Institute, 797 F. 2d at 1078.

A. The Rural Telephone Companies Are Likely to Prevail on the Merits

(i) The New USF Plan Does Not Provide the Rural Telephone Companies With A "Just and Reasonable" Rate of Return on Their Investment And Is Confiscatory In Violation of the Takings Clause of the Fifth Amendment to the Constitution.

The USF Order renders USF support and the recovery of local switching costs via DEM weighting portable to CLECs. In addition, the Order limits the amount of corporate operations expenses that can be recovered from high cost loop support. As demonstrated in Exhibits 2 and 3, these new regulations prevent the Rural Telephone Companies from recovering booked costs and hamper their ability to achieve a reasonable rate of return on their interstate investment. Consequently, these regulations will result in an impermissible "taking" without just compensation in violation of the Fifth Amendment to the U.S. Constitution.

The Takings Clause of the Fifth Amendment provides that private property shall not be taken for public use without just compensation.[14] It is well-settled that ILECs and other public utilities may assert their rights under the Takings Clause.[15] The Fifth Amendment protects utilities from being regulated in a manner that limits charges for their services to levels "so unjust as to be confiscatory."[16] A rate is considered "confiscatory" if it is not "just and reasonable."[17] Thus, the Commission must ensure that ILECs operating in rural, high cost and

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14 U.S. Const. amend. V.

15 See Duquesne Light Co. V. Barasch, 488 U.S. 299, 307 (1989).

16 Id.

17 Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

insular areas are provided with a reasonable opportunity to recover a fair rate of return on their investment (currently set at 11.25 percent).[18]

In order to establish networks capable of providing state-of-the-art services to rural and outlying areas, the Rural Telephone Companies have made significant capital investments; the undepreciated costs associated with building and maintaining this infrastructure remain on the books of the Rural Telephone Companies, even as the purchase of new equipment becomes necessary. Traditionally, USF support and the recovery of local switching costs via DEM weighting was directed in part to recovery of these booked costs. Accordingly, the Commission's new rules making USF support and the recovery of local switching costs via DEM weighting portable have immediate and adverse consequences for the Rural Telephone Companies. Because USF support becomes immediately transitory, CLECs can appropriate per-line USF support, which includes the amounts for booked investments associated with that line previously allocated to the Rural Telephone Companies. Beginning January 1, 1998, the USF Order, the USF Recon. Order and the Access Charge Reform Recon. Order also permit CLECs to take away the Rural Telephone Companies' recovery of local switching investment now accomplished by the DEM weighting separations rules and interstate access charges. By transferring the cost recovery and support based on that investment to competitors, the portability rules unlawfully penalize the Rural Telephone Companies for making past investment in reliance on their ability to gain a fair return.

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[18] Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Memorandum Opinion and Order, 70 RR 2d 26 (1991) (prescribing rate of return on ILEC interstate services of 11.25%).

The treatment, as a portable subsidy, of cost recovery legitimately assigned to the interstate jurisdiction via DEM weighting violates the long-standing Commission policy of recovering costs from the cost-causer. The DEM weighting separations rules recognize that small ILECs experience higher switching costs on a per minute basis. These switching costs are incurred to provide interstate access service to IXCs, they are unrelated to the costs associated with CLEC operations. A large portion of the cost of a rural ILEC's switch relates to central processing hardware and software which varies little with the number of access lines. The processing and software features of the switch are necessary for network functions required by IXCs such as equal access, intraLATA toll dialing parity, toll screening, toll blocking, Signaling System 7 ("SS7"), expanded Carrier Identification Codes ("CICs") and 800 number portability. Therefore, these costs are appropriately recovered through access charges.

In the Interconnection proceeding the Commission acknowledged the need to define a method for recovering booked costs, and promised to address this issue in the USF proceeding:

> To the extent that any such [residual embedded cost] consists of costs of meeting universal service obligations, *the recovery of such costs can and should be considered in our ongoing universal service proceeding*. To the extent a significant residual exists within the interstate jurisdiction that does not fall within the ambit of section 254, we intend to address that issue in our upcoming proceeding on access reform.[19]

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[19] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd 15499, 15859 (1996) ("Interconnection Order")(emphasis added). Indeed, during oral argument on appeal of the Interconnection Order Commission counsel stated:

> There's absolutely no reason why as part of that [universal service process] a competitively neutral fund that everyone pays can't be collected and used to

(continued...)

Despite these statements, the USF Order reaches no conclusion regarding the extent of residual booked costs, and fails to establish a method of compensating the Rural Telephone Companies for any shortfalls resulting from portability. Instead, the Access Charge Reform Recon. Order denies the recovery of booked local switching investment by directing the Rural Telephone Companies to reduce the local switching rates they charge IXCs.

The adverse impact of the Commission's decision on "average schedule" ILECs will be similar to that endured by small cost companies. Average schedule companies' interstate settlements are based on a NECA-derived formula designed to simulate payments to a cost company of similar size and therefore include a weighted DEM component which must be identified and shifted to the new USF.[20]

Furthermore, many states have prescribed intrastate access rates that mirror NECA's interstate access rates. If these states reduce their traffic sensitive access charges to reflect changes NECA must make as a result of the elimination of the DEM weighting, but do not develop an intrastate USF funding mechanism to account for the change, the Rural Telephone Companies will also experience immediate and substantial intrastate revenue reductions. The

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[19] (...continued)
reimburse any stranded or embedded costs that exist. The access charge proceeding, the same possibility there.

Iowa Utilities Board v. FCC, 109 F. 3d 418 (8th Cir. 1996), Transcript of Oral Arguments of Counsel, January 17, 1997. Indeed, while the commission indicates in the Access Reform proceeding that it will examine "historical costs" recovery in a separate order in that docket, no such order has been issued. Access Charge Reform, First Report and Order, CC Docket No. 96-262, FCC 97-158, slip op at ¶14 ("Access Charge Reform") (rel. May 16, 1997).

[20] 47 C.F.R. § 69.606(a).

attached Exhibits 2 and 3 show the harm that will be inflicted upon several Rural Telephone Companies as the result of these drastic changes to the interstate DEM weighting separations rules. In many instances, there will be even greater negative impacts on intrastate revenues.

Even if the Rural Telephone Companies are able to retain 100% of their customers, and therefore maintain USF support and interstate local switching cost recovery at current levels, they will suffer a substantial reduction in their interstate rate-of-return. This is because, as demonstrated in Exhibit 2, the cap on corporate operations expenses will reduce the annual interstate rate-of-return for many Rural Telephone Companies to negative amounts. Likewise, as demonstrated in Exhibit 3, the average schedule Rural Telephone Companies will have significant difficulty earning a reasonable rate-of-return due to the substantial loss of settlements that will be caused by the USF Order. Thus, under no circumstances will the Rural Telephone Companies have a reasonable opportunity to recover a fair rate of return on their investment.

Under the standard for determining whether a rate is reasonable, "the regulatory body must balance the interests of both the investor and consumer."[21] "From the investor or company point of view, it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business..." From the consumers point of view the return on equity should be "commensurate with returns on investments in other enterprises having corresponding risks."[22] Due to the significant reduction in the rate of return and loss of interstate average schedule settlements shown in Exhibits 2 and 3 that will be caused by the USF Order,

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21 Hope Natural Gas, 320 U.S. at 602.

22 Id.

the USF Recon. Order, and the Access Charge Reform Recon. Order, the Rural Telephone Companies will not have sufficient revenues to cover operating expenses as well as the capital costs of their business. Therefore, under the standard discussed in Hope Natural Gas, the Commission's rules are "confiscatory" in violation of the Fifth Amendment "takings" clause. Accordingly, the Rural Telephone Companies seek a stay of the cap on corporate operations expenses, the USF portability rules, and the Commission's treatment of the DEM weighting separations rules as a subsidy, rather than as an accurate cost allocation mechanism.

(ii) The New USF Plan is Arbitrary and Capricious in Violation of the Administrative Procedures Act

In promulgating a new regulation, an agency must consider all relevant data and demonstrate that its action reflects a "'rational connection between the facts found and the choices made.'"[23] The Court has "frequently reiterated that an agency must cogently explain why it has exercised its discretion in a given manner."[24] When an agency action is not supported by the facts, is contrary to the stated goals of the agency or Congress, and is not accompanied by a reasoned explanation, it is considered to be "arbitrary and capricious."[25] Such a regulation may

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[23] See Motor Vehicle Manuf. Assn. of the U.S., Inc. v. State Farm Mutual Auto. Ins. Company, 463 U.S. 29, 43 (1983).

[24] Id. At 48; see also 5 U.S.C. § 557(c)(3)(A) (all agency decisions must include a statement of findings and conclusion, and the reasons and basis therefor, on all material issues of fact, law or discretion presented on the record); See v. Washington Metro. Area Transit Auth., 36 F.3d 375, 384-86 (4th Cir. 1994); Garret v. FCC, 513 F.2d 1056, 1060 (D.C. Cir 1975) (absence of the explanation required by the Administrative Procedures Act is fatal to the validity of an administrative decision).

[25] Motor Vehicle Manuf. Assn., 463 U.S. at 43; Bechtel v. FCC, 10 F.3d 875, 885-

(continued...)

be set aside pursuant to Section 706 of the Administrative Procedures Act ("APA").[26] As explained in greater detail below, the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order, do not further, and in some cases directly contravene, long-standing Congressional and Commission policies. In addition, there is no rational connection between the facts found in those proceedings and the new regulations. Thus, those sections of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order requiring portability of USF support and the recovery of local switching costs through DEM weighting, treating the DEM weighting separations rules as a subsidy, and setting an unjustified cap on the recovery of corporate operations expenses are arbitrary and capricious, and must be stayed.

(a) It Is Arbitrary and Capricious To Treat The DEM Weighting Separations Rules As A Per-Line "Subsidy" Borne By All USF Contributors, Rather than IXCs, When the Most Expensive Features of A Digital Switch Are Required By the IXC Network and Involve Usage Sensitive Charges.

The Commission, in adopting new USF rules, has arbitrarily labeled the DEM weighting separations rules as an implicit "subsidy,"[27] when in fact it is an important cost recovery mechanism that properly assigns small ILEC local switching costs to the interstate jurisdiction for recovery from IXCs, the entities that cause small ILECs to incur the lion's share of their switching costs. By first changing the existing DEM weighting rules to an interim approach

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25 (...continued)
886 (D.C. Cir. 1993).

26 5 U.S.C. § 706(2)(A).

27 USF Order, at ¶ 212.

funded by all USF contributors, and eventually eliminating DEM weighting entirely, the Commission has created a subsidy program for IXCs by shifting costs away from them and onto the backs of all USF contributors. In doing so, the Commission has, without explanation, improperly abandoned its oft espoused principle of requiring costs of telecommunications services to be recovered from the cost causer, which in the case of the majority of local switching costs, is the IXC.[28]

The DEM weighting separations rules are targeted to the smallest carriers (i.e., those with less than 50,000 access lines) typically operating in sparsely populated rural areas. Switching costs for these companies are significant, particularly in light of the small number of end-users served. Despite the fact that the Rural Telephone Companies have smaller service areas and typically serve fewer customers, their switching costs are closer to those of the larger LECs, and much higher on a per minute basis. As shown in Exhibit 4 attached hereto, Rural Telephone Companies ranging in size from about 800 access lines to about 5,200 access lines have spent between $87,575 and $367,515 just to upgrade their digital switches for equal access, SS7, CLASS and related network functions. Such expenditures are necessary for both large and small ILECs primarily to facilitate the provision of the advanced features and functions required by IXCs but has a greater cost impact on smaller ILECs, on a per-minute basis.

Unlike larger ILECs, which enjoy economies of scale that permit them to spread their investment over a larger number of exchanges, small ILEC operations cannot take advantage of

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[28] See Access Charge Reform Order, at ¶75.

such economies.[29] Larger ILECs also benefit from economies of scale that afford them discounts from manufacturers to purchase switching equipment. Current DEM weighting separations rules properly assign a greater share of the local switching costs to access charges to be recovered from IXCs because, as demonstrated above, IXCs are responsible for a majority of the local switching costs incurred by small ILECs. The Commission has not only arbitrarily created a subsidy program for IXCs by shifting costs away from them and to all USF contributors, but by making the recovery of such costs portable, the Commission has deprived the Rural Telephone Companies of any opportunity to recover a fair return on their local switching investments, whether from IXCs or other USF contributors.

The Commission's decisions making USF support and the recovery of local switching investment through DEM weighting portable are also inconsistent with Section 254(e) of the Act, which mandates that USF support be used "only for provision, maintenance and upgrading facilities and services."[30] As with the Commission's Open Network Architecture ("ONA") rules, the simple fact that parts of the Rural Telephone Companies' networks are made available on an unbundled basis does not render the elements of the Rural Telephone Companies' networks any less the property of the Rural Telephone Companies.[31] Thus, although CLECs may purchase

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[29] USF Order at ¶ 294 ("compared to large ILECs, rural carriers generally serve fewer subscribers, serve more sparsely populated areas, and do not generally benefit as much from economies of scale and scope").

[30] 47 U.S.C. § 254(e).

[31] See Filing and Review of Open Network Plans, Memorandum Opinion and Order, Phase I, 4 FCC Rcd 1 (1988); Order on Reconsideration, 5 FCC Rcd 3084 (1990); Memorandum Opinion and Order, 5 FCC Rcd 3103 (1990).

unbundled network elements to serve a particular customer, the Rural Telephone Companies should continue to receive the USF support necessary for the provision, maintenance and upgrading of facilities and services, since they provide the facilities for which USF is used.

(b) The FCC Decision To Cap the Amount of Corporate Operations Expenses That Can Be Recovered From High Cost Loop Support Is Arbitrary In Violation of the APA Because There is No Evidence That the Current Overhead Needed to Serve High Costs Areas Is Excessive.

The USF Order limits recovery of corporate operations expenses through the high cost loop fund to a Commission-determined "range of reasonableness."[32] The Commission arbitrarily arrived at its "reasonable range" without first determining whether corporate operations expenses for Rural Telephone Companies serving high cost areas are unreasonable or excessive. The cap sets a specific per-line amount of permissible corporate operations expenses that may be included for calculating loop costs. To set the cap, the Commission appears to have utilized a Commission staff-prepared analysis of NECA cost data developed prior to passage of the Act. This data does not properly reflect increases in corporate operations expenses incurred by the Rural Telephone Companies, or those likely to be incurred in the future, which result from the Commission's implementation of the Act. Therefore, this data cannot be relied upon to set per-line expense amounts.

Corporate operations expenses are recorded in Part 32 Accounts 6710 and 6720 and include expenses for legal, accounting and finance, executive and planning, procurement, research and development, information management, and other general and administrative

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[32] USF Order, at ¶ 283.

expenses.[33] The Rural Telephone Companies have already experienced significant increases in operations expenses as they scramble to comply with the requirements of the new USF regime as well as to analyze the provision of services based on forward looking costs.[34] Given the complexities of the new regulatory environment, the Rural Telephone Companies have been and will continue to be forced to incur additional corporate operations expenses to conduct research, develop plans and procure necessary equipment and consulting services in order to ensure compliance with the new rules. The Commission's decisions to limit corporate operations expenses fail to take into account the fact that the Rural Telephone Companies are now incurring new and substantial operations expenses in furtherance of the new Commission-defined universal service and changes to its access charge rules. Moreover, the data used by the Commission could not possibly determine whether current levels of corporate operations expenses are excessive or unreasonable and inconsistent with Section 254(k) of the Act. Nor does this flawed data accurately set "reasonable" expense levels, particularly at this time when the Commission is requiring increases in these expenses. Thus, this regulation is arbitrary and capricious and must be stayed pursuant to Section 706 of the APA.[35]

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[33] 47 C.F.R. §§32.6710 and 32.6720; See also, Bell Atlantic Telephone Companies, Transmittal Nos. 741 and 786, Revisions to Tariff F.C.C. No. 10, Rates, Terms, and Conditions for Video Dialtone Service in Dover Township, New Jersey, Order Designating Issues for Investigation, 11 FCC Rcd. 2024, fn.53. (1995).

[34] Interconnection Order, 11 FCC Rcd 15449.

[35] 5 U.S.C. § 706(2)(A).

(c) It Is Contrary to Statutory USF Goals to Limit High Cost Loop Recovery When a Rural Exchange Is Acquired and Upgraded

The Commission's decision to limit the high cost loop recovery of ILECs acquiring new exchange property is inconsistent with the Section 254(b) universal service principles and contrary to Section 7 of the Act.[36] The decision discourages investment in switching and network upgrades in portions of rural America most in need of such investment. Rural ILECs have an exemplary record of quality service to rural America. Today, many rural communities, particularly in western portions of the U.S., benefit from modern quality services taken for granted by suburban and urban subscribers (e.g., single party services), only because rural ILECs have had incentives to acquire and upgrade neglected exchanges. Thus, limiting the recovery of costs by ILECs acquiring new exchanges does not advance and preserve universal service goals.

The Commission's justification for limiting high loop cost recovery, i.e., to discourage carriers from placing "unreasonable reliance upon potential universal service support in deciding whether to purchase exchanges," is unfounded. First, the Commission has already limited potential universal service support through continuation of its indexed cap on USF and modifications to USF support mechanisms for high cost areas. Second, exchange acquisitions must still be approved by the Commission through the study area waiver process to determine whether USF support for upgrading such acquired exchanges serves the public interest. Rather than rely on a blanket prohibition, the Commission should use existing procedures to evaluate

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[36] USF Order at ¶308.

transactions on a case-by-case basis providing a more tailored approach to addressing the Commission's concerns and the public interest. This blanket prohibition undermines, rather than furthers, the Commission's universal service goals. Furthermore, the facts in the record do not support the Commission's decision regarding this method for limiting high cost loop recovery. Thus, the provision is arbitrary and capricious and should be stayed.[37]

(d) The USF Order Violates the Regulatory Flexibility Act By Creating Hardship for Small Businesses

In adopting new regulations, the Regulatory Flexibility Act requires the Commission to consider significant alternatives that minimize the impact on small businesses.[38] The Commission's Final Regulatory Flexibility Act Analysis accompanying the USF Order demonstrates that the Commission has failed to consider significant alternatives to, e.g., avoid an unlawful "taking" of small ILEC property in violation of the Fifth Amendment.

Rather than providing regulatory flexibility to eliminate the "takings" problem confronting the Rural Telephone Companies, the Commission has created an insurmountable hardship for these small U.S. businesses. Accordingly, the Rural Telephone Companies request that the Commission stay those portions of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order, requiring the portability of USF support and DEM weighting local switching cost recovery, the treatment of the DEM weighting separations rules as a subsidy, and the arbitrary cap on the amount of corporate operations expenses that can be recovered through the high cost loop fund.

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[37] 5 U.S.C. § 706(2)(A).

[38] 5 U.S.C. § 603, *et seq.*

B. The Rural Telephone Companies Will be Irreparably Injured Absent a Stay

The Rural Telephone Companies will be irreparably injured if those aspects of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order setting an arbitrary cap on corporate operating expenses, requiring portability of USF support and the recovery of local switching costs through DEM weighting, and treating the DEM weighting separations rules as a subsidy are not stayed. The combined impact of rate churn, the inability to maintain quality service at affordable rates, and the lack of resources necessary to make further investment in new technology and innovative services will result in the permanent loss of goodwill and reputation, and an eroded customer base that can never be fully restored. In addition, enforcement of these regulations will deny the Rural Telephone Companies a just and reasonable return on their investment in contravention of their Fifth Amendment rights, resulting in losses that will be impossible to recover or even to measure. Moreover, these regulations will significantly hamper the ability of the Rural Telephone Companies to negotiate agreements for interconnection, resale or reciprocal compensation; thereby irreparably distorting any such contractual relationships. Accordingly, those parts of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order setting an arbitrary cap on the corporate operations expenses that can be recovered from the high cost loop fund, requiring the portability of USF support and the recovery of local switching costs through DEM weighting, and treating the DEM weighting separations rules as a subsidy must be stayed.

(i) The Rural Telephone Companies' Permanent Loss of Customers, Goodwill and Reputation Constitutes Irreparable Injury

It is manifest that loss of customers, customer goodwill and business reputation represents irreparable injury.[39] Implementation of the sections of the USF Order, the USF Recon. Order, and the Access Charge Reform Recon. Order setting an arbitrary cap on the recovery of corporate operations expenses, requiring portability of USF support and the recovery of local switching costs through DEM weighting, and treating DEM weighting separations rules as a subsidy will significantly impede the Rural Telephone Companies' ability to continue to maintain quality service at affordable rates, and to make investments and implement upgrades necessary to provide the services demanded by their customers. In light of the competition now faced by the Rural Telephone Companies, this Commission-imposed competitive handicap will clearly result in the loss of customers, customer goodwill and impair the business reputation of the Rural Telephone Companies. Thus, implementation of these regulations will cause irreparable harm.

Under the portability regulations, CLECs have the ability to take per-line USF support away from the Rural Telephone Companies. In addition, beginning January 1, 1998, CLECs may appropriate the Rural Telephone Companies' recovery of local switching costs now provided for by the DEM weighting separations rules. Furthermore, beginning on January 1, 1998, the USF Order, and the USF Recon. Order arbitrarily limit the recovery of corporate operations expenses from high cost loop assistance. The Rural Telephone Companies rely

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[39] See Multi-Channel TV Cable Co. v. Charlottesville Quality Cable Operating Co., 22 F.3d 546, 552 (4th Cir. 1994)(the possibility of permanent loss of customers to a competitor, or goodwill, constitutes irreparable injury); Iowa Utilities Board v. FCC, 109 F.3d at, 426.

heavily on these sources of income; the drastic reduction in revenue which will occur as the result of this new regulation will make it virtually impossible for them to perform the upgrades to satisfy their customers' demands and requirements imposed by the Commission.

As equipment used by the Rural Telephone Companies ages, its value depreciates and loss of USF and local switching cost recovery makes it difficult, if not impossible, for these small companies to make new investments in infrastructure. In particular, lack of financial resources places limitations on their ability to acquire costly new technology required for the new features and functionalities demanded by customers. This predicament is made worse by the Commission's arbitrary restriction on the recovery of corporate operations expenses.

The Commission's new USF rules require carriers to make significant new investments to upgrade switches and infrastructure, in some cases prior to January 1, 1998, in order to be recognized as an "eligible telecommunications carrier" by their state commissions.[40] In order to be considered "eligible" for USF, ILECs must provide "single party service" and "voice grade access to the public switched network."[41] Single party service requires 3.5 KHz, bandwidth between 500 and 4000 Hz. Existing networks, however, are designed to operate at between 300 and 3300 Hz. Thus, the Rural Telephone Companies will be required to replace virtually their entire networks in order to comply with this requirement.

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[40] See 47 C.F.R. § 54.201(a)(1).

[41] 47 C.F.R. §§ 54.101(a)(1) and (a)(4).