

BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D.C. 20054

ORIGINAL

In the Matter Of )

Federal-State Joint Board on )  
Universal Service )

CC Docket No. 96-45

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

PETITION FOR RECONSIDERATION

ITCS, INC.

David A. Irwin  
Tara S. Becht

Irwin, Campbell & Tannenwald, P.C.  
1730 Rhode Island Ave., N.W. Suite 200  
Washington, D.C. 20036  
(202) 728-0400

Its attorneys

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**PETITION FOR RECONSIDERATION**

ITCs, Inc., an economic cost consultant to independent telephone companies serving America's rural areas, on behalf of Chariton Valley Telephone Company, Columbine Telephone Company, Cunningham Telephone Company, ETEX Telephone Cooperative, Moka Dial, Inc. - Kansas, Moka Dial, Inc. - Missouri, Moultrie Independent Telephone Company, Inc., Steelville Telephone Company, South Central Telecommunications of Kiowa, South Central Telephone Association - Kansas, South Central Telephone Association - Oklahoma, Tri Country Telephone Association, Inc., TCT West, Inc., and Wiggins Telephone Association, by its counsel pursuant to Section 1.106 of the Commission's Rules, 47 C.F.R. §1.106, respectfully petitions the Commission for reconsideration of the Federal-State Joint Board on Universal Service *Report and Order* adopted on May 7, 1997 and released on May 8, 1997.<sup>1</sup> ITCs respectfully requests that the Commission reconsider its *Report and Order* in so far as it failed to recognize the need for universal service support on a current basis. ITCs also requests the Commission reconsider its *Report and Order* and permit carriers to exclude expenses attributable to federal regulatory costs from the amount of corporate operating expenses being capped and permit the federal

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<sup>1</sup> *In re, Federal-State Joint Board on Universal Service, Report and Order*, 62 FR 32862, CC Docket No. 96-45 (rel. May 8, 1997), (hereinafter "*Report and Order*").

regulatory related costs to be added to the capped amount for inclusion in the USF submission for determination of LEC costs per loop.<sup>2</sup>

## BACKGROUND

1. Since the provision of telephone service on a commercial basis began there has been a recognition of the need for support or contributions between high cost/low profit elements and low cost/high profit elements. As the years progressed the need for this support became more and more obvious primarily because the barriers of distance, that is, the length of a circuit from a central office and related costs to provide service, and density, the number of customers that could be served from common facilities, became more apparent as service was extended from the central city business districts out to the urban residential and rural areas.

2. Initially, this support took the form of a contribution from the long distance aspect of telephone service to the local service elements. Furthermore, the support was initially granted in order to enhance the industry; that is, as more people were connected to the network and as they began using long distance services, the profits of the long distance element were enhanced, and some of these profits were used to foster more local service growth. This created a cycle that was beneficial for the new telephone industry and provided a new and valuable service to unserved areas.

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<sup>2</sup> ITCs recognizes that the Commission reconsidered, *sua sponte*, the *Report and Order* and adopted changes to the formula used to calculate the cap on corporate operations expenses. *In re, Federal-State Joint Board on Universal Service*, Order on Reconsideration, CC Docket No. 96-45 (rel. July 10, 1997). ITCs limits its petition for reconsideration to the *Report and Order* in that it is not petitioning that the Commission reconsider its methodology for calculating the cap, rather ITCs requests the Commission remove the cap as it applies to costs attributable to federal regulatory expenses. Therefore, it is appropriate at this time for ITCs to petition the Commission for reconsideration of this issue. However, ITCs reserves the right to petition the Commission for reconsideration of its *Order on Reconsideration* when it becomes timely.

3. With the dawn of telephone service provided in a monopoly based environment, the industry's policy of universal service began to flourish and additional forms of contribution evolved. Business services provided support to residential services through "value of service" pricing wherein the higher business service rates supported the lower rated residential services. Urban rates were also priced higher than rural rates through this value of service pricing concept and, therefore, urban services supported rural services such that rural customers paid the same rates as urban customers. In both of these cases, the costs of providing lower rated services (residential and rural) were higher than those of the supporting services (business and urban).

4. Other forms of support evolved through the economies of scale that are inherent in providing service in high density, high usage locations such as the "Northeast Corridor". Through nation-wide average pricing, a portion of the benefits from these efficiencies could be directed toward low density, low usage, high cost areas. Because large companies benefit the most from these economies of scale, they are the source of this support. Generally, small companies are the companies that serve sparsely populated, low usage, high cost areas and by their nature are the ones who receive this contribution.

5. These contributions expanded with the evolution of universal service as a public policy. Beginning with the Communications Act of 1934 and up to the present, support mechanisms have become the single major factor in this country's success in deploying a near universal telecommunications network and with it becoming the greatest economic force in the world. What is most important to realize is the fact that forms of support were available to the recipient at the point of either payment or settlement for the services involved. In other words, support

was made available to correspond with the time the service was provided-- it was recognized that time was of the essence.

6. With the onset of competition in the industry through changes in law and public policy, some forms of support began to break down inasmuch as the very existence of a flow of support was indicative of the absence of economically based costs and, therefore, product pricing that only enticed wise entrepreneurs. Accordingly, if the support was to be deemed essential to the preservation and enhancement of a generally recognized public policy (in this case, universal service), the support needed to become explicitly in nature and the burden shared by all.

7. This was recognized by the establishment of the Universal Service Fund in 1984 by the FCC through the Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order, 96 FCC 2d 781 (1984). Because the Commission could obviously not recognize present day conditions, these rules differed from the past in that they do not permit the receipt of support at the point in time costs are incurred. More specifically, as opposed to the receipt of support through current period settlements or when telecommunications bills are paid, present day USF payments are based on actual costs incurred between nine months and two years prior to payment. As a consequence, a provider incurring high costs in the provision of quality service must wait from nine months to two years before recovering its costs; this is the burden being sustained by all telephone companies that require USF support.<sup>3</sup>

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<sup>3</sup> See, ITCs' Petition for Waiver on Behalf of Tri-County Telephone Association and TCT West, Inc. for Waiver of Part 36, Paragraphs 36.611(a) and 36.612, USF Data Submission Schedule, filed November 12, 1996 where Tri-County Telephone Association, a small rural co-operative located near Yellowstone National Park acquired several RBOC rural exchanges located between its existing exchanges with the hope of providing improved service. The Wyoming Public Service Commission indicated in its order approving the acquisition that it expected service improvements. Due to the timing of the purchase and the interruption of the study over USF payments, all support

**COMPETITION AND HISTORICAL CONTRIBUTION  
MECHANISMS CANNOT CO-EXIST**

8. Simply stated, competition and the type of contribution mechanisms mentioned above cannot co-exist. If these mechanisms are utilized in a competitive environment, those companies without support obligations that compete in the low cost, high profit element of the business have a strong competitive advantage over companies providing support because they can operate without the incumbrance of support obligations.

9. Accordingly, the Telecommunications Act of 1996 and the FCC's Orders and Rules implementing the provisions of the Act require that all forms of support be identified, become explicit and be included in an independent revenue flow that leaves the remaining elements free to compete on an economic basis.

10. The present day Universal Service Fund attempts to accomplish this with the traditional toll to local support flow. The mechanism, phased in over an eight year period was established in its present manner because long distance services were one of the first attacked by competition.

11. As the implementation of the fund neared completion, its methods came under increasing scrutiny and criticism even from those who were instrumental in its formation and who benefited most from its existence. As is so often the case, those who can afford to complain the most, are heard without regard for the merits of their concerns or an understanding of the underlying factors behind a given situation.

12. Such was the case in CC Docket 80-286, wherein comments were offered by complainants concerning the level of Corporate Operating Expense, a cost which is directly related to the

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previously provided to Tri-County was lost and will not be resumed until 1998.

economies of scale mentioned above. As a result, in the above captioned Report and Order and the Order on Reconsideration, the Commission chose to cap the level of Corporate Operating Expenses that can be recovered through the Universal Service Fund process.

13. A characteristic of the current USF process is the lag between the time costs are incurred and when support from the Universal Service Fund is available to the exchange carrier. When the fund was originally established, it was determined that payments from the fund would be based on actual costs incurred in order to eliminate any speculation. Further, this method limited the carrier to its authorized rate of return and foreclosed any opportunity for the carrier to earn a higher rate of return through traditional rate development and approval processes.

14. This actual-cost based support approach represented a significant departure from the traditional means of providing support through the toll settlement process which allowed carriers to receive support on a current basis. Under the old method, support was provided as part of the current month's settlement subject to a subsequent true-up. However, during deliberations of the current USF rules, the actual cost based approach was deemed acceptable for two reasons. First, the traditional method of providing support was gradually phased out in a manner that limited any significant distortion to the support received due to the 5 percent phase-down process.<sup>4</sup> Second, the funding process did not anticipate the impact of mergers, acquisitions and the formation of new companies because few, if any, were contemplated.

15. Since then, the 5 percent phase down has been completed. Further, the unanticipated corporate activities mentioned above have occurred. The result is that now, companies with significant costs must wait anywhere from nine months to two years before USF is available.

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<sup>4</sup> See, 47 C.F.R. § 36.154(f).

**THE CORPORATE EXPENSE CAP WILL  
PREVENT SMALL COMPANIES FROM PARTICIPATING  
IN THE FEDERAL REGULATORY PROCESS**

16. In its *Order on Reconsideration*, the Commission reconsidered the formula it established in the *Report and Order* to limit the amount of corporate operations expense that carriers can recover from high loop cost support mechanisms. The Commission's formula for calculating the expenses permitted is in terms of "allowable expense per access line served," and offers higher allowable expense for smaller companies with a graduated declining level of allowable expense per line for the larger companies. However, the Commission's cap on corporate operating expenses creates a hardship for small rural companies who wish to stay involved in the federal regulatory process.

17. Only recently has it become critical that rural LECs be able to effectively participate in the regulatory process. In the days of the AT&T monopoly, the overwhelming majority of federal regulatory issues were in the hands of the AT&T Federal Regulatory Affairs Department. Their involvement, coupled with a common rate of return in the Division of Revenues toll settlements process resulted in a fair and equitable regime with minimal, if any, cost to the small independent telephone company.

18. The increase in expenses related to the federal regulatory process began with the divestiture of the Regional Bell Operating Companies from AT&T because small local exchange carriers could no longer depend on AT&T to effectively represent them in the regulatory process. While the National Exchange Carrier Association ("NECA") was established to manage the pooling and tariff elements of the interstate enterprise, they were not in a position to fully act as a federal regulatory interface. Further, while the efforts of many of the national organizations have been very effective in many ways, their constituencies are sufficiently broad in scope and operations that full

representation of the interests of all of their members is not feasible. In many cases, individual representation before the Commission is necessary. However, it will be unaffordable to many small rural telephone companies if the cap on corporate operations expenses is not reconsidered.

19. In addition to limited forms of representation, regulation of the telecommunications industry has changed dramatically in recent years. Where regulation of the industry was a rather straightforward process with only minimal regulatory issues, changes in public policy and the resulting onslaught of competition, violent upheavals in technology and the resulting regulations, and the changing complexion of the industry have left regulators and all parties participating in the regulatory process with enormous responsibilities at the federal level. One need only look at the tremendous impact of the Trilogy<sup>5</sup> on the FCC staff and the companies to gain an appreciation for not only the effort but the results on telecommunications operations to see these changes.

20. One must also recognize how the legislative and regulatory processes have changed over the years. While direct representation is still appreciated, the role of those representing special interests has expanded greatly, particularly in the telecommunications industry where so many different factions, each with their own interests and problems, now participate in the process. And while the FCC staff has been open, accessible and receptive to direct discussions with small company managers, a small company cannot afford the benefits of direct representation in the same manner as the major institutions within the industry with a cap on its Corporate Operating Expenses.

21. Given this environment, the cap on corporate operations expense will have a dramatic effect on a small rural telephone companies's ability to remain active in the regulatory process, even though

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<sup>5</sup> The Trilogy refers to the implementation of Universal Service, Local Competition and Access Charge Reform.

they recognize that it is necessary to be involved if they are going to survive the trauma of this transition. However, small rural telcos simply cannot afford to remain active because the majority of these expenses will be attributed to intrastate operations by virtue of the Commission cost separations rules<sup>6</sup> and the limitations being placed on the expense adjustment resulting from USF.

22. In short, the economies of scale afforded to large companies allows them to have a major presence at the federal regulatory level and the cap imposed on corporate operations expenses will only make this inequality more blatant. The Commission's *Report and Order* will allow this presence to be of even greater influence because the voices of small rural entities will be silenced by their inability to recover these costs in an equitable and consistent manner. The support mentioned above that comes from the economies of scale is being limited in a manner that denies the small companies the same opportunities as large companies because of their size, even though those same companies share equally in the responsibilities of universal service. But for the undocumented instances of perceived abuse, a small but important constituent in the battle for universal service cannot be represented before the Commission because of the very rules that are intended to promote universal service.

**DELAYS IN USF SUPPORT CREATES  
SERVICE DELAYS AND FINANCIAL HARDSHIPS**

23. Concerning the delay in the receipt of USF support, ITCs, as stated in its comments submitted as part of this proceeding, remains concerned about the lag and its impact on both consumers and local exchange carriers. First, unserved customers should not be subject to delays in receiving service simply because a new service provider must wait for funding. This has

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happened on several occasions and will continue to happen in those cases where a provider does not have the resources to “carry” the costs resulting from this lag.

24. In addition, a LEC should not be denied recovery of costs incurred for the provision of service. Often, these costs have been incurred as part of a state mandate or as part of a service program for unserved subscribers. The end result in any case is extreme economic hardship during the interim period often leading to severe earnings erosion or even negative operating results. This, then, begs the question of regulatory responsibilities as well as the issue of “takings” under the Fifth Amendment to the Constitution.

25. It was hoped that once this anomaly was brought to the attention of the Joint Board and the Commission, the Commission would provide for USF support on a current basis. As has been previously suggested, this could be accomplished through the estimation of costs with an appropriate true-up, an acceleration of the present process or any other similar process that provides for more timely distribution of funding under waiver or demonstration of unusual circumstances.

### CONCLUSION

26. ITCs respectfully petitions the Commission to reconsider its rules that do not permit the recovery of USF support on a current basis. As stated above, recovery of support on a current basis could be accomplished either by using estimates subject to a true-up accelerating the present process or using an accelerated approach when prescribed unusual circumstances prevail or through an effective use of the waiver process.

27. Furthermore, while ITCs does not understand why it is necessary to limit the recovery of corporate operating expenses, ITCs is compelled to respect the Commission's decision for those costs that are not incurred in the federal regulatory process. However, ITCs respectfully requests

the Commission reconsider its decision, and allow for the exclusion of federal regulatory expenses from the amount of corporate operations expenses being capped and that the federal regulatory related costs then be added to the capped amount for inclusion in the USF submission for determination of LEC costs per loop. This approach will allow small rural companies who need support from the large companies' economies of scale, to remain active in federal regulatory affairs and participate in the regulatory process in the same manner as large companies and in a manner that benefits the FCC staff.

Respectfully submitted,

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## BACKGROUND

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### **CONCLUSION**

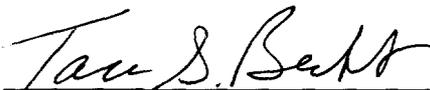
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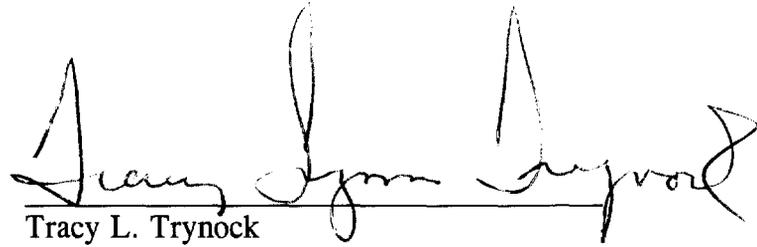
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Washington, D.C. 20036  
(202) 728-0400

Its attorneys

July 17, 1997

CERTIFICATE OF SERVICE

I, Tracy L. Trynock, hereby certify that on this 17th day of July, 1997, copies of the foregoing "ITCs, Inc. Petition For Reconsideration" have been served by first-class United States mail, postage pre-paid, upon the following:

  
Tracy L. Trynock

Stephen G. Kraskin  
Thomas J. Moorman  
Attorneys for U.S. Intelco Networks, Inc.  
Kraskin & Lesse  
2120 L Street, N.W. Suite 520  
Washington, D.C. 20037

William L. Roughton, Jr.  
Attorney for PCS Prineco, L.F.  
1133 20th Street, N.W.  
Suite 850  
Washington, D.C. 20036

Dr. Francis R. Collins  
Consultants to California Cable Television Assn.  
CCL Corporation  
Box 272  
Newton, MA 02159

Alan J. Gardner  
Jerry Yanowitz  
Jeffrey Sinsheimer  
Jennifer A. Johns  
California Cable Television Assn.  
4341 Piedmont Avenue  
Oakland, CA 94611

Donna N. Lampert  
Christopher A. Holt  
Attorneys for California Cable Television Assn.  
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.  
701 Pennsylvania Ave. N.W.  
Suite 900  
Washington, D.C. 20005

Robert S. Foosaner  
Senior Vice President Government Affairs  
Nextel Communications, Inc.  
800 Connecticut Ave., N.W.  
Suite 1001  
Washington, DC 20006

Lawrence R. Krevor  
Director-Government Affairs  
Nextel Communications, Inc.  
800 Connecticut Ave., N.W.  
Suite 1001  
Washington, DC 20006

Laura L. Holloway  
General Attorney  
Nextel Communications, Inc.  
800 Connecticut Ave., N.W.  
Suite 1001  
Washington, D.C. 20006

Daniel L. Brenner  
Neal M. Goldberg  
David L. Nicoll  
Counsel for the National Cable Television Assoc., Inc.  
1724 Massachusetts Ave., N.W.  
Washington, D.C. 20036

Mary Mc Dermott  
Linda Kent  
Charles D. Cosson  
Attorneys for U.S. Telephone Association  
1401 H Street, NW  
Suite 600  
Washington, D.C. 20005

Michael Senkowski  
Jeffrey S. Linder  
Stephen J. Rosen  
Attorneys for The Personal Communications Industry  
Association  
Wiley, Rein & Fielding  
1776 K Street, N.W.  
Washington, D.C. 20006

Robert C. Schoonmaker  
Vice President  
GVNW Inc. Management  
2270 LaMontana Way  
Colorado Springs, CO 80918

J. Manning Lee  
Vice President Regulatory Affairs  
Teleport Communications Group, Inc.  
Two Teleport Drive  
Suite 300  
Staten Island, NY 10311

Gail Garfield Schwartz  
Vice President Public Policy and Government Affairs  
Teleport Communications Group, Inc.  
Two Teleport Drive  
Suite 300  
Staten Island, NY 10311

Kenneth A. Shulman  
Senior Vice President, Technology  
Teleport Communications Group, Inc.  
Two Teleport Drive  
Suite 300  
Staten Island, NY 10311