

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
ETC Annual Reports and Certifications	)	WC Docket No. 14-58
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92

**COMMENTS OF  
ALEXICON TELECOMMUNICATIONS CONSULTING**

Alexicon Telecommunications Consulting (Alexicon) hereby provides these comments regarding the Further Notice of Proposed Rulemaking issued and adopted in the above-captioned proceedings.<sup>1</sup>

Alexicon provides professional management, financial and regulatory services to a variety of small rate-of-return Incumbent Local Exchange Carriers (ILECs) and their affiliates who serve diverse geographical areas characterized by rural, insular or Native American Tribal Lands. These ILECs, similar to most other small rate-of-return regulated ILECs, currently provide a wide range of technologically advanced services to their customers. These companies, through participation in various State and Federal high cost funding programs, and with their continued investment in network infrastructure, are providing customers in rural, insular and Tribal areas with services

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<sup>1</sup> *Connect America Fund et al.*, WC Docket No. 10-90 et al., Further Notice of Proposed Rulemaking, et al., FCC 16-33 (rel. March 30, 2016) (*FNPRM*). Alexicon will also refer to this release at the *RoR USF Reform Order* in areas not related to the *FNPRM*.

equal to or greater than urban areas, and at comparable pricing. Furthermore, these ILECs are committed to providing their customers with innovative solutions, by adapting technologies that fit rural America, including Broadband and IP-enabled services.

In the *FNPRM*, the Commission requests comment on a number of issues surrounding the universal service support mechanisms for rate-of-return (RoR) carriers, including permitted expenses, cost allocation and affiliate transaction rules, reducing support in competitive areas, measures to improve operation of the current RoR system, and streamlining eligible telecommunications carrier (ETC) reporting requirements. All of these issues are important to RoR carriers and their continuing attempts at bringing universal voice and broadband services to rural areas, and could have devastating effects on these efforts if done incorrectly.

## **I. SUMMARY**

Alexicon appreciates the effort that went into the *FNPRM* and the accompanying Report and Order and Order on Reconsideration. The decisions made in these orders will have consequences on not only the directly-affected RoR regulated carriers, but also on the Commission's well-advertised policy for ensuring all Americans have access to quality voice and broadband services. These changes must be implemented carefully and correctly, and the issues raised for comment in the *FNPRM* are no different.

In these Comments, Alexicon will argue that the Commission's focus in the *FNPRM* on policies made presumably necessary by, ostensibly, the result of a very small number of actions by a very small number of RoR carriers is misplaced. The anecdotal evidence presented by the Commission is insufficient to justify the minute details being discussed in the *FNPRM*, especially in the area of permitted expenses, cost allocations, and affiliate transactions. Instead of forcing another level of regulatory reporting on a group of companies arguably overly burdened by these

regulations, the Commission can and should rely on current rules, processes, and oversight to ensure only legitimate costs are being recovered in federal universal service and access charge programs.

Alexicon will also argue that the ETC reporting revisions proposed in the *FNPRM* are necessary and should be enacted immediately, as should the Tribal Broadband Factor proposed by the National Tribal Telecommunications Association. Finally, Alexicon recommends the Commission offer a fourth alternative for disaggregating support in areas with unsubsidized competition that is based on the actual cost to serve the areas in question.

## II. PERMITTED EXPENSES

In the *FNPRM*, the Commission states its intent to “reevaluate the types of expenses that should be permitted – both in a carrier’s revenue requirement and for recovery through high-cost support.”<sup>2</sup> The Commission proposes to accomplish this review via the investigation of several overall concepts, including consideration of the standards to be applied.<sup>3</sup> The standards used now and in the past include “used and useful, prudent expenditure, and necessary for the provision of.”<sup>4</sup> Against this backdrop, the Commission goes on to list a number of expenses or expense categories that are not recoverable by application of these general standards.<sup>5</sup>

### A. The Commission Has Provided Insufficient Evidence for the Need of its Proposals

The impetus behind the focus on permitted expenses, both in the *FNPRM* and a 2015 Public Notice<sup>6</sup>, appears to be a limited number of alleged misdeeds by a very few number of federal USF

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<sup>2</sup> *FNPRM* at 330

<sup>3</sup> *Id.*, at 339

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*, at 340

<sup>6</sup> *All Universal Service High-Cost Support Recipients Are Reminded that Support Must Be Used for its Intended Purposes*, Public Notice, FCC 15-133 (rel. October 19, 2015) (*2015 Public Notice*)

support recipients. In the Statement of Commissioner Ajit Pai attached to the 2015 Public Notice, the focus of Commissioner Pai's considerable ire was one company – Sandwich Isles Communications – which happened to be the subject of ongoing Commission review. In *FNPRM*, the Commission references two affiliated high cost support recipients – Adak Eagle Enterprises and Windy City Cellular – as support for the contention that RoR carriers include “questionable expenses in their revenue requirement, using support for purposes unrelated to the provision of services, and misallocating expenses between affiliates, or between regulated and non-regulated activities.”<sup>7</sup> Considering the breadth of the issues being raised in the *FNPRM*, substantial and unwarranted weight is being placed on the supposed misdeeds of three high cost support recipients. Prior to embarking on a process that will cause yet more regulatory burden, in the form of additional certifications and the efforts that must be undertaken to ensure the certifications can be signed, the Commission should present additional, empirical evidence that a substantial number of RoR carriers are improperly recovering these expenses. Absent this showing, it appears that the Commission has overgeneralized anecdotal evidence to apply in some wide-ranging way to all RoR carriers; the Commission, in other words, has proposed a solution that is in search of a problem.

Recent experience, in fact, presents a different narrative as to the prevalence of improper recovery of costs. According to the Universal Service Administrative Company, the FCC Office of Inspector General (OIG) directed USAC to perform three rounds of random “compliance attestation” audits of USF beneficiaries and contributors.<sup>8</sup> According to USAC, the Round 1 recoveries (i.e., refunds by carriers of improper payments) were \$171,924 and \$0 in Round 2,

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<sup>7</sup> *FNPRM* at 330

<sup>8</sup> USAC Analysis of the Federal Communications Commission Office of Inspector General 2008 Reports on the Universal Service Fund (February 12, 2009) (*USAC 2009 Report*)

while the cost of the Round 1 and 2 audits were in excess of \$145 million. In USAC's report to the FCC, it was concluded that "the FCC OIG reported no instances of fraud in any of the programs as a result of either Round One or Round Two [OIG audits], and in fact the results revealed a generally high level of program compliance by beneficiaries..."<sup>9</sup> At least two lessons can be learned from USAC's reports: (1) incidents of improper cost recovery are rare, and (2) the costs of the audit efforts far outweigh any benefits gained. Alexicon cautions the Commission to proceed carefully before adopting any new rule relating to permitted expenses without the necessary evidence that there is an industry-wide problem in the first place, and also recommends the Commission streamline targeted oversight metrics and audit engagement tools to better detect the abusers of the federal programs.

### **B. The Commission Already Has Adopted Mechanisms to Guard Against Recovery of Improper Costs**

As noted in the *2015 Public Notice*, "the Commission continues to look at methods of limiting expenses to reasonable levels, with a primary focus on corporate operations expenses that are excessive."<sup>10</sup> Indeed, the Commission has limited corporate operations expenses recoverable in the High Cost Loop Support (HCLS) mechanism<sup>11</sup>, and adopted an operating expense capping mechanism that will be applicable to the new Broadband Line Support (BLS) mechanism as well as to HCLS.<sup>12</sup> The explicit intent of these mechanisms is to address Commission concerns that "companies not receive more support than is necessary to provide service and that carriers subject to rate-of-return regulation have sufficient incentive to be prudent and efficient in their

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<sup>9</sup> *USAC 2009 Report* at II

<sup>10</sup> *2015 Public Notice* at 2

<sup>11</sup> 47 CFR §54.1308(a)(4)

<sup>12</sup> *RoR USF Reform Order* at 98

expenditures, and in particular operating expenses.”<sup>13</sup> With the implementation of the operating expense caps adopted in the *RoR USF Reform Order*, recovery of many expenses via the HCLS and CAF BLS is constrained. Given this, and the cap on interstate switched end office rates and related recovery mechanism adopted in the *USF Transformation Order*<sup>14</sup>, the only revenue requirement that will be affected by operating expenses that are not currently capped or otherwise constrained is that related to non-BLS interstate special access.

To now propose another procedure to further constrain recovery of operating expenses, without adequate evidence supporting the need for such a mechanism, is unreasonable and unnecessary at this time. The Commission should allow the newly adopted operating expense capping mechanism to work, and determine if this cap, along with the other constraining and compliance mechanisms, will adequately address the Commission’s largely unsupported concerns.

### **C. Specific Permitted Expenses or Categories of Expenses**

Alexicon in large part agrees with the list of non-recoverable expenses initially included in the *FNPRM*<sup>15</sup> and in the *2015 Public Notice*.<sup>16</sup> These expenses, including, for example, personal travel, entertainment, and penalties on late payment of debt, have typically not been recoverable in the past, and should remain so on a going forward basis. However, Alexicon believes the Commission’s list of non-recoverable expenses is too encompassing, and does not allow for or recognize the complexities of serving in rural areas of the United States or how small businesses are operated. For example, charitable donations, scholarships, and membership fees for clubs and

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<sup>13</sup> *RoR USF Reform Order* at 95

<sup>14</sup> *In the Matter of Connect America Fund*, et. al., WC Docket No. 10-90, etc., Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (rel. November 18, 2011) at 736-923

<sup>15</sup> *FNPRM* at 340

<sup>16</sup> *2015 Public Notice* at 2

organizations are often vital in maintaining good corporate citizenship in RLEC serving areas. In many instances, the RLEC is one of the largest employers and companies in the area, and their participation in the community is vital. This, in turn, can assist the RLEC in assessing community communication needs and better plan for future network investment or improvements. As a result, a blanket prohibition on recovery of these types of expenses is not reasonable. As with many issues that arise in RoR ratemaking, in order to properly balance the needs and rights of the customers and the investors, the company and regulators must carefully examine the transactions and determine, in large part on a case-by-case basis, whether a particular expense is necessary for the provision of regulated service. Given the sheer number of transactions taking place, this type of review is clearly not possible; therefore, carrier certification that expenses included are reasonable and in compliance with Commission rules is a practical method to meet the Commission's goals.

The Commission also presents a list of additional expenses to be prohibited from cost recovery, including, artwork, childcare, cafeterias and dining facilities, and housing allowances.<sup>17</sup> Alexicon objects to the exclusion of these expenses for the following reasons. First, artwork and other items possessing aesthetic value are important for not only maintaining a pleasant work place but also for customers to enjoy. Second, childcare expenses are, in some circumstances, necessary for attracting and retaining quality personnel. In the high cost rural areas served by many RoR RLECs, child care facilities are uncommon and this presents a serious problem for qualified employees. By providing for or contributing towards child care, RLECs are better able to attract and retain qualified employees, which may be scarce in many areas. For housing allowances, this is again a cost that is often involved in the attracting and retention of qualified employees. For

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<sup>17</sup> FNPRM at 342

these expenses, the Commission cannot adopt a blanket prohibition on regulated recovery of these costs.

Finally, Alexicon notes that the Internal Revenue Service maintains a comprehensive list of business expenses recognizable for federal income tax reporting purposes.<sup>18</sup> While not a perfect template for costs allowable in a telecommunications RoR regulation context, IRS guidelines represent the results of significant experience of what is a reasonable and allowable expense necessary for the operation of a business. As such, the Commission should review IRS documentation relating to allowable expenses and adjust the lists of non-permitted expenses contained in the *FNPRM* accordingly.

### **III. COST ALLOCATIONS AND AFFILIATE TRANSACTIONS**

The Commission brings up several cost allocation and affiliate transactions issues for comment, including whether there are circumstances surrounding transactions between non-affiliated parties that might raise questions and whether affiliate transaction rules should be applied to transactions with non-affiliates<sup>19</sup>, and on adopting new rules to improve the process of allocating costs among regulated and non-regulated services and between affiliates.<sup>20</sup> Perhaps more critically, the Commission wonders how it can better detect cases of misallocation.

Again, the Commission provides little to no evidence that current cost allocation and affiliate transaction rules are not working, or are being used to manipulate and artificially increase interstate access charges, settlements, or high cost support. Instead, a list of mostly theoretical concerns is provided, upon which the case is then made that some rather radical, detailed, and

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<sup>18</sup> See e.g., IRS Publication 535, "Business Expenses"

<sup>19</sup> *Id.*, at 350, 351

<sup>20</sup> *Id.*, at 355

ultimately onerous revisions to affiliate transactions and cost allocations rules are proposed. The concerns stated by the Commission in the *FNPRM* include:

- Transactions between affiliates when one of the parties has a close family relationship with the regulated carrier, or the boards of directors share members.<sup>21</sup>
- The lack of specificity in the cost allocation and affiliate transaction rules gives carriers incentive to allocate as many costs as possible to regulated operations.<sup>22</sup>
- The potential for carriers to provide shared operational services to their affiliates under fully-distributed cost (FDC) allocation procedures that do not include all of the associated costs.<sup>23</sup>

As with the discussion of permitted expenses above, the Commission provides scant evidence beyond hypothetical situations and theoretical nefarious incentives. While Alexicon agrees that, if the above examples were to actually occur, the carrier would be in violation of Commission rules, there needs to be some greater amount of evidence of these actually taking place on a widespread basis before the Commission initiates such a substantial revision of its affiliate transaction and cost allocation rules. Furthermore, as referenced above, USAC has reported that recent audit efforts have turned up very little non-compliance with Commission rules, including, presumably, those related to cost allocation and affiliate transactions. Alexicon contends that more targeted audit-type procedures or processes outside the realm of burdensome audits themselves to pinpoint abusers of the system is in the best interest of all parties. As an example, most companies in the industry are required to have independent financial audits. These auditors are experienced in the industry and would perhaps be an ideal outlet for enacting additional audit procedures to address this issue.

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<sup>21</sup> *Id.*, at 350

<sup>22</sup> *Id.*, at 353

<sup>23</sup> *Id.*, at 356

As for incentives to comply with the Commission's cost allocation and affiliate transaction rules, the vast majority of carriers are under constant scrutiny or threat of scrutiny from state commissions, the National Exchange Carrier Association, USAC, and the FCC itself. As rate-of-return regulated carriers, the companies that would be subject to the proposed rules are well aware of the importance of proper cost allocations and affiliate transactions procedures, and acknowledge this through signed certifications submitted to various entities each year.

Considering that current evidence shows the Commission's existing cost allocation and affiliate transaction rules are working as intended, any concern the Commission may have about, for example, the allocation of costs to non-regulated retail broadband services is a matter of degree, and not one of kind. Given that RoR regulated carriers in substantial measure comply with Commission rules, adopting major revisions would not serve to address any concerns, however real these concerns ultimately prove to be. Therefore, the Commission should gather and present sufficient evidence that interstate revenue requirements and/or federal universal service support payments are being materially inflated due to misapplication of cost allocation and affiliate transaction rules prior to adopting any changes.

#### **IV. REDUCING SUPPORT IN COMPETITIVE AREAS - DISAGGREGATION**

The Commission invites commenters to propose other methods of support disaggregation than what is offered in the *RoR USF Reform Order*.<sup>24</sup> Disaggregation of support is needed in order to better recognize the costs associated with areas not overlapped by unsubsidized competition, which tend to be lower cost areas.<sup>25</sup> The Commission offers three alternatives:

- (1) carriers may choose to disaggregate their CAF BLS based on the relative density of competitive and non-competitive areas.

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<sup>24</sup> *Id.*, at 138

<sup>25</sup> *Id.*,

- (2) carriers may choose to disaggregate their CAF BLS based on the ratio of competitive to non-competitive square miles in a study area, as proposed by Hargray.
- (3) carriers may choose to disaggregate their CAF BLS based on the ratio of A-CAM calculated for competitive areas compared to A-CAM support for the study area.

Alexicon proposes a fourth alternative that is based on the actual cost to serve the areas under consideration.<sup>26</sup> While not all carriers will have the means to implement this type of specific cost disaggregation, the option should be available to those carriers with the ability to do so. As noted in the *RoR USF Reform Order*, the Commission took a similar approach in the past and allowed carriers to submit individual disaggregation plans.<sup>27</sup> As was adopted previously, all such carrier-specific disaggregation plans should be supported by a description of the rationale used, including the methods and data relied upon to develop the disaggregation zones (census blocks). The plan should provide information sufficient for interested parties to make a meaningful analysis of how the carrier derived its disaggregation plan, and must be reasonably related to the cost of providing service for each disaggregation zone within each disaggregated category of support.

## V. TRIBAL SUPPORT

The Commission requests comment on issues surrounding a proposal made by the National Tribal Telecommunications Association (NTTA) and Gila River Telecommunications, Inc. (GRTI) to implement a Tribal Broadband Factor (TBF). The TBF is “designed to address the broadband deployment canyon that exists on Tribal lands by targeting additional funding to any

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<sup>26</sup> While the Commission expresses its preference to “avoid complex allocations of the cost of facilities that serve both competitive and non-competitive areas...”, Alexicon believes a cost-based option is the most accurate and therefore should be made available.

<sup>27</sup> *RoR USF Reform Order* at 138 and footnote 295

rate-of-return carrier serving such lands.”<sup>28</sup> Alexicon fully supports the TBF proposal as outlined by NTTA and GRTI.

While the Commission focuses on the details surrounding the need for the TBF and how to best utilize such funding, the fact remains that, overall, Tribal areas are woefully underdeveloped when it comes to broadband availability. As shown in the Commission’s latest Broadband Progress Report, 68% of Americans living in rural Tribal areas lack access to broadband services meeting the Commission’s minimum standards (10/1 mbps, etc).<sup>29</sup> The results are even worse when considering only rural Tribal areas in the lower 48 states, where 72% of Americans lack access to broadband services.<sup>30</sup> These facts alone provide the Commission all the reasons it needs to implement the TBF, or other similar mechanism, as quickly as possible. It’s a matter of fairness and equity, not one of regulatory minutiae.

## **VI. STREAMLINING ETC ANNUAL REPORTING REQUIREMENTS**

The Commission proposes a number of changes to ETC annual reporting requirements designed to eliminate unnecessary and duplicative reports. Reporting requirement to be eliminated include outage information, unfulfilled service requests, number of complaints per 1,000 subscribers for both voice and broadband services, pricing for both voice and broadband service, and certification of compliance with applicable service quality standards.<sup>31</sup> In addition, the Commission proposes to eliminate the requirement that ETCs file duplicate copies of their annual

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<sup>28</sup> *FNPRM* at 371, referencing a June 19, 2015 Ex Parte filing by NTTA.

<sup>29</sup> *2016 Broadband Progress Report*, GN Docket No. 15-191, released January 29, 2016, at p.34, Table 1

<sup>30</sup> *Id.*, at p. 35, Table 2

<sup>31</sup> *FNPRM* at 388

reports (Form 481) with the FCC and the applicable state/Tribal governmental entity, given that the Form 481 data will be made accessible online.<sup>32</sup>

Alexicon supports these revisions to the ETC annual reporting requirements. As noted by the Commission, the reports targeted for elimination consist of items that are either obtainable elsewhere or are otherwise duplicative. For example, pricing for voice services charged by RoR carriers can be obtained in publicly available tariffs, and pricing for broadband services is required to be disclosed online pursuant to the Commission's Open Internet rules.<sup>33</sup> In addition, making Form 481 data better accessible to interested parties online will save considerable time and expense incurred annually by RoR carriers as they will no longer have to compile the necessary copies, designate certain items as confidential, and typically engage the services of regulatory counsel to ensure the data is filed on time and in the proper state/Tribal proceeding.

## CONCLUSION

Alexicon urges the Commission to first present sufficient empirical evidence that the current standards for determining expenses that are properly recoverable via interstate revenue requirements and federal universal service support programs are insufficient and are leading to significant inflation of payments to RoR carriers prior to enacting any sweeping rule changes. The *FNPRM* contains scarce, and only anecdotal, evidence and is hardly sufficient for adopting the major changes and reporting requirements contemplated. Similarly, the Commission presents insufficient evidence for making the changes proposed to its affiliate transaction and cost allocation rules. Lastly, as it relates to permitted expenses, Alexicon recommends the Commission allow the sweeping reforms from the *RoR USF Reform Order* to take effect, and monitor the

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<sup>32</sup> *Id.*, at 391

<sup>33</sup> See 47 CFR §8.3

progress accordingly. Before pursuing additional actions that could be counterproductive, have unintended consequences, and disincen companies resulting from lack of sufficient funding, the Commission should allow the current reforms to work before assuming yet additional reforms are necessary.

The Commission should move immediately to implement the Tribal Broadband Factor, or similar mechanism, proposed by the National Tribal Telecommunications Association. Finally, Alexicon supports the Commission's specific proposals to streamline annual ETC reporting rules by eliminating certain reporting and filing requirements, and urges the Commission to adopt a fourth option for disaggregating support between competitive and non-competitive areas that is based on actual cost.

Respectfully Submitted,

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May 12, 2016