

229. We now consider the inputs related to the calculation of depreciation expenses. The model uses "adjusted projected lives" to recover the current costs of the assets.³⁹⁹ Under this approach, the annual depreciation charges associated with an asset are computed by dividing the asset's current cost by its adjusted projected life.⁴⁰⁰ A shorter life will increase the annual depreciation expense.

230. In the *Universal Service Order*, the Commission concluded that "economic lives and future net salvage percentages used in calculating depreciation expense should be within the FCC-authorized range" and use currently authorized depreciation lives.⁴⁰¹ In the *1997 Further Notice*, the Commission tentatively concluded that it should adopt depreciation expenses that reflect a weighted average of the rates authorized for carriers that are required to submit their rates to us.⁴⁰² The Commission also sought comment on whether adjusted projected asset lives should reflect the lives of facilities and equipment dedicated to providing only the services supported by universal service or whether the asset lives should reflect a decision to replace existing plant with plant that can provide broadband services.⁴⁰³ The *May 4 Public Notice* requested further information on these issues.⁴⁰⁴

2. Issues for Comment

a. Method of Depreciation

231. Before selecting values for projected life and future net salvage value, we first tentatively adopt the method of depreciation that should be used in the model, that is, how depreciation allowances should be allocated over the life of an asset. The Commission's

³⁹⁹ *1997 Further Notice*, 12 FCC Rcd at 18570, para. 149. The projected life of an asset is the asset's expected service life at installation, reflecting not only the physical life of the equipment, but also the obsolescence associated with the replacement of older equipment with equipment that uses new technologies and forecasts of future replacements. The adjusted projected life of an asset is its projected life adjusted by its future net salvage value. Future net salvage is the percentage of the asset's value that the owner expects to obtain when selling the asset at the end of its useful life. *Id.*

⁴⁰⁰ Depreciation charges are computed in this manner for the first year. In subsequent years, depreciation charges are computed using reserve.

⁴⁰¹ *Universal Service Order*, 12 FCC Rcd at 8913-14, para. 250 (criterion 5).

⁴⁰² *1997 Further Notice*, 12 FCC Rcd at 18571, para. 152.

⁴⁰³ *Id.*

⁴⁰⁴ *See Inputs Public Notice.*

depreciation accounting rules require carriers to use straight-line equal-life group depreciation.⁴⁰⁵ Both the HAI and BCPM proponents advocate the use of straight-line depreciation in calculating depreciation expenses.⁴⁰⁶ Ameritech suggests that the depreciation method used for a specific geographic area should be consistent with any studies that underlie the development of economic lives or net salvage values for that same area.⁴⁰⁷ GTE proposes that incumbent LECs be allowed to use depreciation lives based on the expected economic life of the asset.⁴⁰⁸ Because the Commission's rules require the use of straight-line depreciation, rather than a more accelerated depreciation method, we tentatively conclude that this method, which is used for all Commission-proposed depreciation, is also appropriate for use in the high cost support mechanism. We seek comment on this tentative conclusion.

b. Depreciation Lives and Future Net Salvage Percentages

232. In estimating depreciation expenses, the model uses the projected lives and future net salvage percentages for the asset accounts in Part 32 of the Commission's rules.⁴⁰⁹ Traditionally, the projected lives and future net salvage values used in setting a carrier's rates have been determined in a triennial review process involving the state commission, the Commission, and the carrier. In order to simplify this process, the Commission has prescribed ranges of acceptable values for projected lives and future net salvage percentages.⁴¹⁰ The Commission's prescribed ranges reflect the weighted average asset life for regulated telecommunications providers. These ranges are treated as safe harbors, such that carriers that incorporate values within the ranges into their depreciation filings will not be challenged by the Commission. Carriers that submit life and salvage values outside of the

⁴⁰⁵ 47 C.F.R. § 32.2000(g). Straight-line depreciation is an accounting technique in which an asset's value is divided into equal parts over its useful life. The equal-life group procedure subdivides assets according to age. *See Amendment of Part 31 (Uniform System of Accounts for Class A and B Companies) so as to Permit Depreciable Property to be Placed in Groups Comprised of Units with Expected Equal Life for Depreciation Under the Straight-Line Method*, Report and Order, 83 FCC2d 267 (1980), recon., 87 FCC2d 916 (1981), supplemental opinion, 87 FCC2d 1112 (1981).

⁴⁰⁶ HAI June 1, 1998 comments at 14; BCPM June 1, 1998 comments at 8.

⁴⁰⁷ Ameritech June 12, 1998 reply comments at 2-3.

⁴⁰⁸ GTE June 12, 1998 reply comments at 19. GTE urges the Commission to allow incumbent LECs to use the same depreciation rates and salvage values as they use for financial reporting or, in the alternative, to establish a range based on the depreciation rates and salvage values used by interexchange carriers and competitive LECs for their financial reporting.

⁴⁰⁹ *See* 47 C.F.R. § 32.2000(j)

⁴¹⁰ *See* 47 C.F.R. § 32.2000(g)(iii).

prescribed range must justify their submissions with additional documentation and support.⁴¹¹ Commission authorized depreciation lives are not only estimates of the physical lives of assets, but also reflect the impact of technological obsolescence and forecasts of equipment replacement. We believe that this process of combining statistical analysis of historical information with forecasts of equipment replacement generates forward-looking projected lives that are reasonable estimates of economic lives and, therefore, are appropriate measures of depreciation.

233. In the *1997 Further Notice*, the Commission tentatively concluded that it should adopt depreciation expenses that reflect a weighted average of the rates authorized for carriers that are required to submit their rates to us.⁴¹² The values submitted by the HAI sponsors essentially reflect such a weighted average. The HAI values represent the weighted average depreciation lives and net salvage percentages from 76 study areas.⁴¹³ According to the HAI sponsors, these depreciation lives and salvage values reflect the experience of the incumbent LEC in each of these study areas in retiring plant, and its projected plans for future retirements.⁴¹⁴

234. We tentatively conclude that HAI's values represent the best forward-looking estimates of depreciation lives and net salvage percentages.⁴¹⁵ We seek comment on this tentative conclusion. Generally, these values fall within the ranges prescribed by the Commission for projected lives and net salvage percentages. Although the HAI values for four account categories fall outside of the Commission's prescribed ranges,⁴¹⁶ these values still reflect the weighted average of projected lives and net salvage percentages that were approved by the Commission and therefore are consistent with the approach proposed in the *1997 Further Notice*. As noted above, the fact that an approved value falls outside of the prescribed range simply means that the carrier that proposed the value was required to provide additional justification to the Commission for this value. We are satisfied that HAI

⁴¹¹ The Commission has proposed streamlining the depreciation prescription process by, *inter alia*, expanding the prescribed range for the digital switching plant account and eliminating salvage from the depreciation process. See *1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, CC Docket No. 98-137, 13 FCC Rcd 20542 (1998).

⁴¹² *1997 Further Notice*, 12 FCC Rcd at 18571, para. 152.

⁴¹³ HAI June 1, 1998 comments at 10.

⁴¹⁴ *Id.*

⁴¹⁵ The proposed values for these inputs are listed in Appendix A.

⁴¹⁶ HAI's lives and salvage values fall within the Commission's prescribed ranges with the exception of values for four accounts: Digital Circuit Equipment; Garage Work Equipment; Operator Systems; and Poles.

calculated its proposed rates using the proper underlying depreciation factors and that HAI's documentation supports the selection of these values.

235. We disagree with the BCPM sponsors and other incumbent LECs that the Commission's prescribed ranges are not appropriate for determining depreciation rates in a competitive environment.⁴¹⁷ These parties argue that rapid changes in technology and the opening of local telecommunications markets to competition shorten asset lives significantly beyond what the Commission has prescribed.⁴¹⁸ The BCPM sponsors claim that these factors cause existing equipment to become obsolete at a faster pace, thus reducing the overall economic value of the assets more quickly.⁴¹⁹ We agree with the HAI sponsors that there is no evidence to support the claim that increased competition or advances in technology require the use of shorter depreciation lives in the model than are currently prescribed by the Commission.⁴²⁰ The Commission's prescribed lives are not based solely on the engineered life of an asset, but also consider the impacts of technological change and obsolescence. We note that the depreciation values we tentatively adopt are generally at the lower end of the prescribed range. We further note that although the average depreciation rate for an incumbent LEC's Total Plant in Service is approximately seven percent, incumbent LECs are retiring plant at a four percent rate. This difference has allowed depreciation reserves to increase so that the depreciation reserve-ratio is greater than 50 percent. We tentatively conclude that the existence of this difference implies that the prescribed lives are shorter than the engineered lives of these assets. In addition, this difference provides a buffer against technological change and competitive risk for the immediate future. We therefore tentatively conclude that the Commission's prescribed ranges are appropriate to determine depreciation rates for the model. We seek comment on these tentative conclusions.

236. We tentatively decline to adopt the values for projected lives and net salvage percentages submitted by the BCPM proponents. The BCPM proponents based their default values for projected lives and salvage on a LEC industry data survey requesting forward-looking values.⁴²¹ With regard to projected lives, the BCPM values generally fall outside of

⁴¹⁷ Aliant June 1, 1998 comments at 3-4; Ameritech June 1, 1998 comments at 4; BCPM June 1, 1998 comments at 11-13; GTE June 1, 1998 comments at 15-16; Southwestern June 1, 1998 comments at 9-10.

⁴¹⁸ BCPM June 1, 1998 comments at 12; Southwestern June 1, 1998 comments at 17; GTE June 1, 1998 comments at 16; Ameritech June 1, 1998 comments at 4.

⁴¹⁹ BCPM June 1, 1998 comments at 9-10.

⁴²⁰ HAI June 1, 1998 comments at 13.

⁴²¹ BCPM Dec. 11 submission at 80.

the Commission's prescribed ranges.⁴²² Because the BCPM sponsors fail to introduce sufficient evidence supporting their values, we tentatively decline to accept their approach. The BCPM proponents submitted values for projected life that are significantly shorter than the already shortened Commission's prescribed life ranges.⁴²³ This is significant because BCPM's values that fall outside of the prescribed ranges represent accounts that reflect the overwhelming majority of plant investment, thus potentially triggering a dramatic increase in support. We seek comment on this assessment.

B. Cost of Capital

237. The cost of capital represents the annual percentage rate of return⁴²⁴ that a company's debtholders and equity holders require as compensation for providing the debt and equity capital that a company uses to finance its assets.⁴²⁵ In the *Universal Service Order*, the Commission concluded that the current federal rate of return of 11.25 percent is a reasonable rate of return by which to determine forward-looking costs.⁴²⁶

238. The HAI proponents have submitted data indicating that the incumbent LEC's cost of capital is 10.01 percent, not the current 11.25 percent federal rate of return.⁴²⁷ The HAI proponents also contend that certain state commissions have determined that even lower costs of capital are appropriate.⁴²⁸ The BCPM proponents advocate a cost of capital rate of 11.36 percent.⁴²⁹

⁴²² The eight categories in which BCPM's values fall outside required ranges for projected lives were: Digital Circuit Equipment; Digital Switching; Aerial Cable-Metallic; Aerial Cable-Non-Metallic; Underground Cable-Metallic; Underground Cable-Non-Metallic; Buried Cable-Metallic; and Buried Cable-Non-Metallic. The two categories in which BCPM's values fall outside required ranges for net salvage percentage were Digital Circuit Equipment and Poles.

⁴²³ BCPM Dec. 11 submission at 80.

⁴²⁴ Rate of return is the percentage which a telephone carrier is authorized to earn on its rate base. For example, if the rate of return is 11.25% and the rate base is \$1 million, the carrier is authorized to earn \$112,500.

⁴²⁵ See *Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, Second Report and Order, CC Docket No. 93-316212 FCC Rcd 18370, 18765 (1997).

⁴²⁶ *Universal Service Order*, 12 FCC Rcd at 8913, para. 250.

⁴²⁷ HAI June 1, 1998 comments at 13.

⁴²⁸ *Id.* at 13.

⁴²⁹ BCPM Dec. 11 submission.

239. We find that both BCPM and HAI proponents have failed to make an adequate showing to justify rates that differ from the current 11.25 percent federal rate of return. We tentatively conclude, therefore, that the current rate is reasonable for determining the cost of universal service. If the Commission, in a rate prescription order, adopts a different rate of return, we tentatively conclude the model should use the more recently determined rate of return. We seek comment on these tentative conclusions.

C. Annual Charge Factors

240. Incumbent LECs develop cost factors, called "annual charge factors," to determine the dollar amount of recurring costs associated with acquiring and using particular pieces of investment for a period of one year. Incumbent LECs develop these annual charge factors for each category of investment required. The annual charge factor is the sum of depreciation, cost of capital, adjustments to include taxes on equity, and maintenance costs.

241. To develop annual charge factors, the BCPM proponents propose a model with user-adjustable inputs to calculate the depreciation and cost of capital rates for each account.⁴³⁰ The BCPM proponents state that this account-by-account process was designed to recognize that all of the major accounts have, *inter alia*, differing economic lives and salvage values that lead to distinct capital costs.⁴³¹ HAI's model is also user adjustable and reflects the sum for the three inputs: depreciation, cost of capital, and maintenance costs.⁴³²

242. Because the synthesis model uses HAI's expense module, with modifications, we tentatively conclude that HAI's annual charge factor should be used.⁴³³ We believe that HAI's annual charge factor is consistent with other inputs used in the model adopted by the Commission, and therefore easier to implement. We seek comment on this analysis and our tentative decision to use HAI's annual charge factor.

IX. OTHER ISSUES RELATED TO THE HIGH COST MECHANISM

A. Alternatives to the Forward-Looking Cost Model

⁴³⁰ BCPM Dec. 11 submission at 80.

⁴³¹ *Id.* BCPM's model includes all of the methodologies that are in practice today, including: Deferred taxes; Mid-year, Beginning Year, and End Year placing conventions; Gompertz-Makeham Survival Curves; Future Net Salvage Values; Equal Life Group Methods; and others. The model also incorporates separate Cost of Debt and Equity rates, along with the Debt to Equity ratio. *Id.*

⁴³² HAI Dec. 11 submission at 41.

⁴³³ The expense module contains the expense values including, plant specific maintenance ratios, and the algorithms that determine monthly cost per-line given the results of all other modules.

243. It is our expectation that the model outputs will be fully verified in time for implementation on January 1, 2000, and we remain firmly committed to the idea that support based on forward-looking costs will provide the best assurance of predictable, specific, and sufficient support as competition develops. In the unlikely event that the model is not ready for timely implementation, however, we seek comment on how the Commission might determine support levels without resort to a forward-looking cost model. Commenters addressing this issue should specifically describe how their proposal will generate sufficient support to meet the goals of section 254, even as competition develops in the local exchange.

B. Proposed Modification to Procedures for Distinguishing Rural and Non-Rural Companies

1. Background

244. In the *Universal Service Order*, the Commission determined that rural and non-rural carriers will receive federal universal service support determined by separate mechanisms, at least until January 1, 2001.⁴³⁴ The Commission stated that it would define rural carriers as those carriers that meet the statutory definition of a rural telephone company in section 153(37) of the Communications Act.⁴³⁵ Under this definition, a "local exchange carrier operating entity" is deemed a "rural telephone company" to the extent that such entity-

(A) provides common carrier service to any local exchange carrier study area that does not include either--

(i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or

(ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(C) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(D) has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.

245. In addition, the Commission determined that LECs should self-certify their

⁴³⁴ *Universal Service Order*, 12 FCC Rcd at 8927, para. 273.

⁴³⁵ See 47 U.S.C. § 153(37); *Universal Service Order*, 12 FCC Rcd at 8944, para. 310.

status as a rural company each year to the Commission and their state commission.⁴³⁶ On September 23, 1997, the Common Carrier Bureau (Bureau) released a Public Notice requiring carriers seeking to be classified as rural telephone companies to file a letter with the Commission by April 30 of each year certifying that they meet the statutory definition.⁴³⁷ The *Self-Certification Public Notice* requires a LEC certifying as a rural carrier to explain how it meets at least one of the four criteria set forth in the statutory definition.⁴³⁸ On March 16, 1999, the Bureau released a Public Notice revising the annual deadline for LECs seeking to be classified as rural carriers to July 1 of each year.

2. Issues for Comment

246. On June 22, 1998, the Accounting Policy Division released a Public Notice with a list of the approximately 1,400 carriers that had certified as rural carriers as of April 30, 1998.⁴³⁹ Because a vast majority of the carriers certifying as rural serve under 100,000 access lines, we tentatively conclude that we should adopt new filing requirements for carriers filing rural self-certification letters. We propose that carriers who serve under 100,000 access lines should not have to file the annual rural certification letter unless their status has changed since their last filing.⁴⁴⁰ We believe that this is a better approach because the overwhelming majority of the companies that filed rural certification letters qualified as rural telephone companies because they provide service to fewer access lines than either the 50,000 or 100,000 line thresholds identified in the statute. Access line counts can be verified easily with publicly-available data. Further, this relaxation in filing requirements would lessen the burden on many rural carriers and Commission staff. We estimate that this change will eliminate the filing requirement for approximately 1,380 of the carriers that filed this year. We seek comment on this proposal.

247. As noted above, the Commission can easily determine whether a carrier

⁴³⁶ *Universal Service Order*, 12 FCC Rcd at 8943-44, para. 310.

⁴³⁷ *Self-Certification as a Rural Telephone Company, Public Notice*, DA 97-1748 (rel. Sept. 23, 1997) (*Self-Certification Public Notice*).

⁴³⁸ *See* 47 U.S.C. § 153(37).

⁴³⁹ *Commission Acknowledges Receipt of Letters Self-Certifying LECs as Rural Telephone Companies, Public Notice*, DA 98-1205 (rel. June 22, 1998). Under current procedures, each of these carriers would have to submit another rural certification by July 1, 1999.

⁴⁴⁰ The National Exchange Carrier Association, Inc. (NECA) has requested that the Commission eliminate the annual rural certification process. NECA states that the majority of carriers that meet the rural definition are small LECs with limited resources, and whose status is not likely to change. Letter from Richard A. Askoff, NECA to Irene Flannery, Chief, Accounting Policy Division, FCC, dated April 9, 1999.

satisfies criteria (B) or (C) of the rural telephone company definition,⁴⁴¹ because these criteria are based on information that can be verified easily with publicly available data -- the number of access lines served by a carrier. In contrast, criteria (A) and (D) require additional information and analysis to verify a carrier's self-certification as a rural company. Specifically, under criterion (A) a carrier is rural if its study area does not include "any incorporated place of 10,000 inhabitants or more" or "any territory ... in an urbanized area," based upon Census Bureau statistics and definitions.⁴⁴² Under criterion (D) a carrier is rural if it had "less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the [1996 Act]."⁴⁴³

248. We tentatively conclude that, once we have clarified the meaning of "local exchange operating entity" and "communities of more than 50,000" in section 153(37), we should require carriers with more than 100,000 access lines that seek rural status to file certifications for the period beginning January 1, 2000, consistent with the Commission's interpretation of the rural telephone company definition. We seek comment on this tentative conclusion. We also seek comment on whether we should require these carriers to re-certify each year (after the filing for January 1, 2000) or, in the alternative, whether they should be required to re-certify only if their status has changed.

249. Most of the carriers asserting rural status under criterion (A) or (D) also claim rural status under the access line thresholds in criterion (B) or (C).⁴⁴⁴ In these cases, the Commission does not need additional information to verify the carrier's rural status. If a carrier serves a local exchange study area with more than 100,000 access lines, however, the Commission needs additional information about the study area to determine whether criterion (A) or (D) is met. Based on the certifications we have received, we believe that carriers have adopted differing interpretations of criterion D. We tentatively conclude that criterion A, on the other hand, by referencing Census Bureau sources, can be applied consistently without further interpretation by the Commission. We seek comment on this tentative conclusion.

250. We have identified at least two issues in the rural telephone company definition for which carriers have adopted different interpretations that affect the determination of whether a carrier satisfies the requirements of criterion D. Specifically, carriers differ on whether criterion (D) should be applied on a holding company or study area-by-study area basis. For example, while most carriers have asserted that they meet the 15 percent/50,000

⁴⁴¹ 47 U.S.C. § 153(37)(B), (C).

⁴⁴² 47 U.S.C. § 153(37)(A).

⁴⁴³ 47 U.S.C. § 153(37)(D).

⁴⁴⁴ Many carriers claim they meet three or four of the criteria. We also note that many carriers that only cite one criterion may qualify under several criteria.

test in criterion (D) for a particular study area because less than 15 percent of its access lines within that study area are in communities of more than 50,000, at least one carrier claims it meets this criterion for all of its study areas, because less than 15 percent of its access lines nationwide are in such communities. In order to resolve these differences, we must interpret the phrase "local exchange operating entity" in the introductory text of section 153(37).

251. We therefore seek comment on how we should interpret the phrase "local exchange operating entity" in section 153(37) of the Communications Act. Specifically, we seek comment on whether that term refers to an entity operating at the study area level or at the holding company level. Although most of the carriers certifying under subparagraph (D) have construed the term to refer to an entity at the study area level, we note that at least one state commission, in denying a carrier's request for an exemption under section 251(f)(1) of the Communications Act, viewed the exemption claim from the perspective of the national operating entity.⁴⁴⁵ We also request information on how states have construed the rural telephone company definition in exercising their authority under section 251(f)(1) and section 214(e)(2) of the Act.⁴⁴⁶

252. Carriers also have used different interpretations of the phrase "communities of more than 50,000" in criteria (D) of the rural telephone company definition.⁴⁴⁷ Some carriers have used Census Bureau statistics for legally incorporated localities, consolidated cities, and census-designated places, to identify communities of more than 50,000. Other carriers have provided lists of communities without identifying the source of the designation or the population information. Some carriers have attempted to distinguish between rural communities and communities that may be characterized as urban or suburban. One carrier, for example, based its analysis of its service territories on the Commission's definition of "rural area" in section 54.5 of the Commission's rules.⁴⁴⁸ The carrier calculated its percentage

⁴⁴⁵ See 47 U.S.C. § 251(f)(1); Order Denying Motion, Docket No. M-263, Iowa, Department of Commerce Utilities Board (Dec. 11, 1996).

⁴⁴⁶ 47 U.S.C. §§ 214(e)(2), 251(f)(1).

⁴⁴⁷ 47 U.S.C. § 153(37)(D).

⁴⁴⁸ Section 54.5 provides the following definition of rural area:

A "rural area" is a non-metropolitan county or county equivalent, as defined in the Office of Management and Budget's (OMB) Revised Standards for Defining Metropolitan Areas in the 1990s and identifiable from the most recent Metropolitan Statistical Area (MSA) list released by OMB, or any contiguous non-urban Census Tract or Block Numbered Area within an MSA-listed metropolitan county identified in the most recent Goldsmith Modification published by the Office of Rural Health Policy of the U.S. Department of Health and Human Services."

47 C.F.R. § 54.5.

of rural/non-rural lines by determining whether each of its wire centers is associated with a metropolitan statistical area (MSA). If so, these lines were considered to be urban, unless the wire center has rural pockets, as defined by the most recent Goldsmith Modification.⁴⁴⁹

253. We seek comment on how we should interpret the phrase "communities of more than 50,000" in section 153(37) of the Act. We seek comment on whether we should define communities of more than 50,000 by using Census Bureau statistics for legally incorporated localities, consolidated cities, and census-designated places. In the alternative, we seek comment on whether we should distinguish between rural and non-rural communities in applying criterion D of section 153(37). Specifically, we seek comment on whether we should use the methodology in section 54.5 of the Commission's rules to determine whether a community is in a rural area. We also seek comment on other methods of defining communities with populations greater than 50,000 for purposes of applying criterion D.

254. As noted above, states apply the definition of rural telephone company in determining whether a rural telephone company is entitled to an exemption under section 251(f)(1) of the Act and in determining, under section 214(e)(2) of the Act, whether to designate more than one carrier as an eligible telecommunications carrier in an area served by a rural telephone company.⁴⁵⁰ Although the Commission used the rural telephone company definition to distinguish between rural and non-rural carriers for purposes of calculating universal service support, there is no statutory requirement that it do so. The Commission adopted the Joint Board's recommendation to allow rural carriers to receive support based on embedded cost for at least three years, because, as compared to large LECs, rural carriers generally serve fewer subscribers, serve more sparsely populated areas, and do not generally benefit as much from economies of scale and scope.⁴⁵¹ The Commission also noted that for many rural carriers, universal service support provides a large share of the carriers' revenues, and thus, any sudden change in the support mechanisms may disproportionately affect rural carriers' operations.⁴⁵² We seek comment on whether the Commission should reconsider its decision to use the rural telephone company definition to distinguish between rural and non-rural carriers for purposes of calculating universal service support. That is, we seek comment on whether there are differences between our universal service policies and the competitive policies underlying sections 251(f)(1) and 214(e)(2) that would justify definitions of "rural telephone company" and "rural carrier" that differ.

⁴⁴⁹ See 47 C.F.R. § 54.5.

⁴⁵⁰ 47 U.S.C. §§ 214(e)(2), 251(f)(1).

⁴⁵¹ *Universal Service Order*, 12 FCC Rcd at 8936, para. 294.

⁴⁵² *Universal Service Order*, 12 FCC Rcd at 8936, para. 294.

255. Finally, we address a necessary procedural matter. Currently, carriers are required to file rural certifications by July 1, 1999 to be classified as rural for January 1, 2000. Given our tentative conclusions above that we should modify the current filing requirements for rural certification, including eliminating the filing requirement for most carriers that have filed previously, we move the July 1, 1999 filing deadline to October 15, 1999.

X. PROCEDURAL MATTERS AND ORDERING CLAUSE

A. *Ex Parte* Presentations

256. This is a permit-but-disclose notice-and-comment rulemaking proceeding. *Ex parte* presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in Commission's rules.⁴⁵³

B. Initial Regulatory Flexibility Act

257. As required by the Regulatory Flexibility Act (RFA),⁴⁵⁴ the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by the proposals in this Further Notice. Written public comments are requested on the IRFA. These comments must be filed in accordance with the same filing deadlines as comments on the rest of this Further Notice, and should have a separate and distinct heading designating them as responses to the IRFA. The Commission will send a copy of this Further Notice, including the IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA) in accordance with the RFA.⁴⁵⁵ In addition, the Further Notice and IRFA (or summaries thereof) will be published in the Federal Register.

258. *Need for and Objectives of Proposed Rules.* In the *Universal Service Order*, the Commission adopted a plan for universal service support for rural, insular, and high cost areas to replace longstanding federal subsidies to incumbent local telephone companies with explicit, competitively neutral federal universal service mechanisms. In doing so, the Commission adopted the recommendation of the Joint Board that an eligible carrier's support should be based upon the forward-looking economic cost of constructing and operating the

⁴⁵³ See generally 47 C.F.R. §§ 1.1202, 1.1203, 1.1206.

⁴⁵⁴ See 5 U.S.C. § 603. The RFA, see 5 U.S.C. § 601 *et seq.*, has been amended by the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

⁴⁵⁵ See 5 U.S.C. § 603(a).

networks facilities and functions used to provide the services supported by the federal universal service mechanism.

259. Our plan to adopt a mechanism to estimate forward-looking cost has proceeded in two stages. On October 28, 1998, the Commission completed the first stage of this proceeding: the selection of the model platform. The platform encompasses the aspects of the model that are essentially fixed, primarily assumptions about the design of the network and network engineering. In this Further Notice we move toward completion of the second stage of this proceeding, by proposing input values for the cost model, such as the cost of cables, switches and other network components, in addition to various capital cost parameters. In addition, we propose adoption of a road surrogate algorithm to determine the location of customers and a data set of customer locations. This Further Notice also seeks comment on other issues related to the federal high cost mechanism, including alternatives to the forward-looking cost model and modifications to the procedures for distinguishing rural and non-rural companies.

260. *Legal Basis:* The proposed action is supported by sections 4(i), 4(j), 201-205, 254, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201-205, 254, and 403.

261. *Description and Estimate of the Number of Small Entities to which the Further Notice will Apply.*

262. The RFA generally defines "small entity" as having the same meaning as the term "small business," "small organization," and "small government jurisdiction."⁴⁵⁶ In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act, unless the Commission has developed one or more definitions that are appropriate to its activities.⁴⁵⁷ Under the Small Business Act, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA.⁴⁵⁸ The SBA has defined a small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications Except Radiotelephone) to be small entities when they have no

⁴⁵⁶ 5 U.S.C. § 601(6).

⁴⁵⁷ 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition in the Federal Register."

⁴⁵⁸ 15 U.S.C. § 632. See, e.g., *Brown Transport Truckload, Inc. v. Southern Wipers, Inc.*, 176 B.R. 82 (N.D. Ga. 1994).

more than 1,500 employees.⁴⁵⁹

263. The most reliable source of information regarding the total number of certain common carriers appears to be data the Commission publishes annually in its *Carrier Locator* report, derived from filings made in connection with the Telecommunications Relay Service (TRS).⁴⁶⁰

264. Although some affected incumbent LECs may have 1,500 or fewer employees, we do not believe that such entities should be considered small entities within the meaning of the RFA because they are either dominant in their field of operations or are not independently owned and operated, and therefore by definition not "small entities" or "small business concerns" under the RFA. Accordingly, our use of the terms, "small entities" and "small businesses" does not encompass incumbent LECs. Out of an abundance of caution, however, for regulatory flexibility analysis purposes, we will separately consider small incumbent LECs within this analysis and use the term "small incumbent LECs" to refer to any incumbent LEC that arguably might be defined by the SBA as "small business concerns."⁴⁶¹

265. Local Exchange Carriers. Neither the Commission nor SBA has developed a definition of small local exchange carriers. The closest applicable definition for these carrier-types under SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.⁴⁶² The most reliable source of information regarding the number of these carriers nationwide of which we are aware appears to be data that we collect annually in connection with the TRS.⁴⁶³ According to our most recent data, there are 1,410 LECs.⁴⁶⁴ Although it seems certain that some of these carriers are not independently owned and operated, or have more than 1,500 employees, we are unable at this time to estimate with greater precision the number of these carriers that would qualify as small business concerns under SBA's definition. Consequently, we estimate that there are fewer than 1,410 small

⁴⁵⁹ 13 C.F.R. § 121.201.

⁴⁶⁰ *Carrier Locator: Interstate Service Providers*, Figure 1 (Jan. 1999) (*Carrier Locator*). See also 47 C.F.R. § 64.601 *et seq.*

⁴⁶¹ See 13 C.F.R. § 121.201, Standard Industrial Classification (SIC) 4813. Since the time of the Commission's 1996 decision, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, 16144-45 (1996), the Commission has consistently addressed in its regulatory flexibility analyses the impact of its rules on such incumbent LECs.

⁴⁶² 13 C.F.R. § 121.210, SIC Code 4813.

⁴⁶³ *Carrier Locator* at Fig. 1.

⁴⁶⁴ *Carrier Locator* at Fig. 1.

entity LECs that may be affected by the proposals adopted in this Further Notice. We also note that, with the exception of a modification in reporting requirements, the proposals in this Further Notice apply only to larger "non-rural" LECs.⁴⁶⁵

266. *Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements.*

267. On June 22, 1998, the Accounting Policy Division released a Public Notice with a list of the approximately 1,400 carriers that had certified as rural carriers as of April 30, 1998.⁴⁶⁶ Because a vast majority of the carriers certifying as rural serve under 100,000 access lines, we tentatively conclude that we should adopt new filing requirements for carriers filing rural self-certification letters. We propose that carriers who serve under 100,000 access lines should not have to file the annual rural certification letter unless their status has changed since their last filing.⁴⁶⁷ We believe that this is a better approach because the overwhelming majority of the companies that filed rural certification letters qualified as rural telephone companies because they provide service to fewer access lines than either the 50,000 or 100,000 line thresholds identified in the statute. Access line counts can be verified easily with publicly-available data. Further, this relaxation in filing requirements would lessen the burden on many rural carriers and Commission staff. We estimate that this change will eliminate the filing requirement for approximately 1,380 of the carriers that filed this year.

268. We tentatively conclude that, once we have clarified the meaning of "local exchange operating entity" and "communities of more than 50,000" in section 153(37), we should require carriers with more than 100,000 access lines that seek rural status to file certifications for the period beginning January 1, 2000, consistent with the Commission's interpretation of the rural telephone company definition. We also seek comment on whether we should require these carriers to re-certify each year (after the filing for January 1, 2000) or, in the alternative, whether they should be required to re-certify only if their status has changed.

269. In addition, we address a necessary procedural matter. Currently, carriers are required to file rural certifications by July 1, 1999 to be classified as rural for January 1,

⁴⁶⁵ See *supra* para. 3.

⁴⁶⁶ Commission Acknowledges Receipt of Letters Self-Certifying LECs as Rural Telephone Companies, *Public Notice*, DA 98-1205 (rel. June 22, 1998). Under current procedures, each of these carriers would have to submit another rural certification by July 1, 1999.

⁴⁶⁷ The National Exchange Carrier Association, Inc. (NECA) has requested that the Commission eliminate the annual rural certification process. NECA states that the majority of carriers that meet the rural definition are small LECs with limited resources, and whose status is not likely to change. Letter from Richard A. Askoff, NECA to Irene Flannery, Chief, Accounting Policy Division, FCC, dated April 9, 1999.

2000. Given our tentative conclusions above that we should modify the current filing requirements for rural certification, including eliminating the filing requirement for most carriers that have filed previously, we propose moving the July 1, 1999 filing deadline to October 15, 1999.

270. *Steps Taken to Minimize Significant Economic Impact on Small Entities and Significant Alternatives Considered.* Throughout the Further Notice, we seek comment on the tentative conclusions that we propose. In addition, we believe that the reporting modifications that are proposed above will reduce the burden on rural LECs. As noted, we propose that carriers serving fewer access lines than either the 50,000 or 100,000 line thresholds should not be required to file annual rural certification letters unless their status has changed since their last filing.

271. *Federal Rules That May Overlap, Duplicate or Conflict with the Proposed Rule.* None.

C. Initial Paperwork Reduction Act Analysis

272. This Further Notice contains a proposed information collection. As part of its continuing effort to reduce paperwork burdens, we invite the general public and the Office of Management and Budget (OMB) to take this opportunity to comment on the information collections contained in this Further Notice, as required by the Paperwork Reduction Act of 1995, Pub. L. No. 104-13.⁴⁶⁸ Public and agency comments are due at the same time as other comments on this Further Notice; OMB comments are due 60 days from date of publication of this Further Notice in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other form of information technology.

D. Deadlines and Instructions for Filing Comments

273. Pursuant to Sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments on or before July 2, 1999 and reply comments on or before July 16, 1999. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies. See Electronic Filing of

⁴⁶⁸ A supporting statement, prepared in accordance with the Paperwork Reduction Act, that details the Commission's estimates with respect to the burdens imposed by the proposals in this Further Notice is available from the Commission or from the Office of Management and Budget.

Documents in Rulemaking Proceedings, 63 Fed. Reg. 24,121 (1998).

274. Comments filed through the ECFS can be sent as an electronic file via the Internet to <<http://www.fcc.gov/e-file/ecfs.html>>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the following words in the body of the message, "get form <your e-mail address.>" A sample form and directions will be sent in reply. Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appear in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number. All filings must be sent to the Commission's Secretary, Magalie Roman Salas, Office of the Secretary, Federal Communications Commission, 445 Twelfth Street, S.W., TW-A325, Washington, D.C. 20554.

275. Parties must also send three paper copies of their filing to Sheryl Todd, Accounting Policy Division, 445 Twelfth Street S.W., 5-A523, Washington, D.C. 20554. In addition, commenters must send diskette copies to the Commission's copy contractor, International Transcription Service, Inc., 1231 20th Street, N.W., Washington, D.C. 20037.

E. Ordering Clauses

276. IT IS ORDERED, pursuant to Sections 1, 4(i) and (j), 201-209, 218-222, 254, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-209, 218-222, 254, and 403 that this Further Notice of Proposed Rulemaking IS HEREBY ADOPTED and comments ARE REQUESTED as described above.

277. IT IS FURTHER ORDERED that the Commission's Office of Public Affairs, Reference Operations Division, SHALL SEND a copy of this Further Notice of Proposed Rulemaking, including the Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION



Magalie Roman Salas
Secretary