

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

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In the Matter of)
)
Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-45

RECEIVED

FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: January 10, 2001

Released: January 12, 2001

Comment Date: 30 days after publication in the Federal Register

Reply Comment Date: 45 days after publication in the Federal Register

By the Commission:

I. INTRODUCTION

1. In this Further Notice of Proposed Rulemaking (Further Notice), we seek comment on the Recommended Decision of the Federal-State Joint Board on Universal Service (Joint Board) regarding a plan for reforming the rural universal service support mechanism.¹ The Joint Board sent to the Commission the Rural Task Force Recommendation as a good foundation for implementing a rural universal service plan that benefits consumers and provides a stable environment for rural carriers to invest in rural America.² The Joint Board also identified specific issues for the Commission to address in implementing the Rural Task Force plan.³

II. BACKGROUND

2. The Rural Task Force Recommendation is a proposal for the distribution of universal service support to rural carriers.⁴ It represents the consensus of individual Rural Task Force members, who work for a broad range of interested parties, including rural telephone companies, competitive local exchange carriers, interexchange carriers, wireless providers, consumer advocates, and state and federal government agencies. The Rural Task Force offers its Recommendation as an integrated package, and asks that it be adopted without modification. The Recommendation is designed to be implemented immediately and to remain in place over a five-year period.⁵

¹ *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, FCC 00J-4 (released December 22, 2000) (Recommended Decision). The Recommended Decision, which incorporates the Rural Task Force Recommendation as Appendix A, is attached hereto as Attachment 1.

² *Recommended Decision*, FCC 00J-4 at paras. 1, 10-13. The Rural Task Force was appointed by the Joint Board, and presented its Recommendation to the Joint Board on September 29, 2000. *Id.* at para. 5.

³ *Id.* at paras. 15-19.

⁴ *Id.* at para. 5. "Rural carriers" are local exchange carriers (LECs) that meet the definition of a rural telephone company contained in section 153(37) of the 1996 Act. 47 U.S.C. § 153(37).

⁵ *Recommended Decision*, FCC 00J-4 at para. 5.

3. The Rural Task Force recommends the use of a modified version of the current high-cost loop support mechanism, based on carriers' embedded costs.⁶ It proposes various upward adjustments to current limits on high-cost loop support for rural carriers.⁷ The Rural Task Force also recommends that per-line support levels within a study area become fixed once a competitive eligible telecommunications carrier begins providing service in the study area.⁸ In addition, the Rural Task Force proposes the use of a new annual index to adjust the limits on high-cost loop support, and to adjust per-line support levels in competitive study areas on a going-forward basis.⁹ It also suggests other reforms, such as a "safety valve" mechanism to provide additional support for meaningful post-transaction investment in high-cost telephone exchanges acquired by rural carriers, provision of "safety net additive" support in years in which the cap is triggered for rural carriers with over 14 percent growth in telecommunications plant in service, and a flexible system for disaggregating and targeting per-line support.¹⁰

III. ISSUES FOR COMMENT

4. We seek comment on the Joint Board's conclusion that the Rural Task Force Recommendation is a good foundation for implementing a rural universal service plan for the next several years. Should we adopt the Rural Task Force plan as a means of providing stability to rural carriers over the next several years and encouraging investment in rural infrastructure?¹¹ Does the Rural Task Force plan provide for universal service support that is sufficient for purposes of the Telecommunications Act of 1996?¹² Parties should comment on the public policy implications of the Rural Task Force plan and/or particular aspects of the plan, including its potential effects on the competition and universal service goals of the 1996 Act, and whether and how it would promote consumer welfare. Parties also should address how small business entities, including small incumbent local exchange carriers and new entrants, will be affected by the Rural Task Force plan.¹³

5. We also seek comment on specific implementation issues identified by the Joint Board, as well as any other issues related to implementation of the Rural Task Force Recommendation. First, we invite commenters to address the proposed safety valve mechanism for providing additional support to rural carriers that make meaningful post-transaction investments in acquired exchanges.¹⁴ How should

⁶ *Id.* at para. 6; see 47 C.F.R. §§ 36.601, *et seq.* The Rural Task Force recommends continuation of the other two federal support programs available to rural carriers, Long Term Support and Local Switching Support. See *Recommended Decision*, FCC 00J-4 at para. 6.

⁷ See *id.* at para. 7, Appendix A at §§ IV(B)(1)(a), IV(B)(2). The proposed adjustments include recomputing the indexed cap on high-cost loop support and the corporate operations expense limitation as if they had not been in effect for the calendar year 2000.

⁸ See *id.* at 4-5, para. 7, Appendix A at § IV(B)(1)(c). Under the Rural Task Force's proposal, both the incumbent carrier and the competitive eligible telecommunications carrier would receive fixed per-line support.

⁹ See *id.* at 5, para. 8, Appendix A at § IV(B)(1)(b). The proposed "rural growth factor" would be the sum of annual line growth for rural carriers and a general inflation factor (Gross Domestic Product-Chained Price Index). *Id.*

¹⁰ *Id.* at paras. 7-9, Appendix A at §§ IV(B)(1)(e), IV(B)(3), V(A).

¹¹ See *id.* at para. 5.

¹² Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act); see *Recommended Decision*, FCC 00J-4 at para. 12.

¹³ See Regulatory Flexibility Act, 5 U.S.C. §§ 601, *et seq.*

¹⁴ See *Recommended Decision*, FCC 00J-4 at para. 16, Appendix A at § IV(B)(3).

safety valve support be distributed if the total amount of support for which rural carriers are eligible exceeds the proposed cap of five percent of the high-cost loop support fund? How should “meaningful investment” be defined for purposes of safety valve support?¹⁵ Should a carrier’s safety valve support transfer to a different carrier as a result of a subsequent transfer of exchanges? Should safety valve support be fixed in competitive study areas in the same manner as other high-cost loop support, or would such an approach unduly dissuade investment? We invite commenters to address these and any other issues involved in implementing a safety valve mechanism.

6. Second, we invite commenters to address implementation of the Rural Task Force proposal to fix per-line support in competitive study areas. The Joint Board agreed with the Rural Task Force that the Commission should fix support when a competitor begins providing services in a given study area, but stated that “it is unclear how the high-cost loop fund cap would account for fixed rural carrier support.”¹⁶ We seek comment from interested parties, including the Rural Task Force, on the relationship of the cap on high-cost loop support to fixed per-line support in competitive study areas. We also seek comment on whether the proposed ability of incumbent LECs to adjust their fixed per-line support levels to recover costs associated with catastrophic events should be limited by the availability of support from other sources, such as insurance, Rural Utilities Service loans, and federal or state emergency management relief.¹⁷ Commenters are invited to address these and any other issues involved in implementing the provisions of the Rural Task Force plan for support in competitive study areas.

7. Third, we seek comment on the Rural Task Force proposal to make above-the-cap safety net additive support available in years in which the cap on high-cost loop support is triggered to rural carriers with over 14 percent growth in telecommunications plant in service. As proposed, would the safety net additive mechanism enable rural carriers to recover more than 100 percent reimbursement on their incremental loop investment?¹⁸ If so, how should the mechanism be modified? We invite commenters to address this and any other safety net additive implementation issues. Finally, we invite interested parties to comment on any other issues related to implementation of the Rural Task Force plan.

IV. PROCEDURAL ISSUES

A. Ex Parte Presentations

8. This is a permit but disclose rulemaking proceeding. Ex parte presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in the Commission's rules.¹⁹

¹⁵ For example, is it more appropriate to define meaningful investment so that the “index year expense adjustment” is the year prior to the subsequent year “expense adjustment”? As currently proposed, the index year expense adjustment would be the study area’s high-cost loop support expense adjustment calculated at the end of the acquiring company’s first year of operations. *See id.* at para. 16, n. 47.

¹⁶ *Id.* at para. 17.

¹⁷ *See id.* at para. 18.

¹⁸ *See id.* at para. 19.

¹⁹ *See generally* 47 C.F.R. §§ 1.1202, 1.1203, and 1.1206.

B. Initial Regulatory Flexibility Analysis

9. As required by the Regulatory Flexibility Act (RFA),²⁰ the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of the proposals in this Further Notice. Written public comments are requested on the IRFA. These comments must be filed in accordance with the filing deadlines set forth below in paragraphs 31-35, and should have a separate and distinct heading designating them as responses to the IRFA. The Commission will send a copy of the Further Notice, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA) in accordance with the RFA.²¹ In addition, the Further Notice and IRFA (or summaries thereof) will be published in the Federal Register.²²

1. Need for, and Objectives of, the Proposed Rules

10. The 1996 Act requires the Commission to consult with the Joint Board in implementing section 254, which establishes a number of principles for the preservation and advancement of universal service in a competitive telecommunications environment.²³ The Commission initiated this proceeding to consider the Recommended Decision of the Joint Board regarding a rural universal service plan developed by the Rural Task Force. The Rural Task Force plan is a proposal for the distribution of universal service support to rural carriers which is designed to be implemented immediately and to remain in place over a five-year period. The Joint Board found that the Rural Task Force sought to achieve the goals of the 1996 Act to preserve and advance universal service, facilitate competition in rural areas, and provide a predictable level of universal service support. The Joint Board stated that the Rural Task Force plan would provide rural carriers with stability for planning their investments over the next several years, while seeking to encourage competition in high-cost areas through a flexible system for disaggregating support to establish the portable per-line support amount available to all eligible telecommunications carriers. The Joint Board found that additional support under the plan is “generally designed to provide carriers serving rural areas with increased incentives to invest in new infrastructure and technologies.” In sum, the Joint Board recommended the Rural Task Force plan to the Commission as a good foundation for implementing a rural universal service plan that benefits consumers and provides a stable environment for rural carriers to invest in rural America.

2. Legal Basis

11. This rulemaking action is supported by sections 4(i), 4(j), 201, 205, 254, and 403 of the Communications Act of 1934, as amended.²⁴

3. Description and Estimate of the Number of Small Entities to Which the Notice will Apply

12. The RFA directs agencies to provide a description of, and, where feasible, an estimate of the

²⁰ 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).

²¹ See 5 U.S.C. § 603(a).

²² See *id.*

²³ 47 U.S.C. § 254.

²⁴ 47 U.S.C. §§ 154(i), 154(j), 201-205, 254, and 403.

number of small entities that may be affected by the proposed rules, if adopted.²⁵ The RFA generally defines "small entity" as having the same meaning as the term "small business," "small organization," and "small governmental jurisdiction."²⁶ 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.²⁷ 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.²⁸

13. We have included small incumbent carriers in this RFA analysis. A "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (e.g., a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."²⁹ The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent carriers are not dominant in their field of operation because any such dominance is not "national" in scope.³⁰ We have therefore included small incumbent carriers in this RFA analysis, although we emphasize that this RFA action has no effect on the Commission's analyses and determinations in other, non-RFA contexts.

14. *Local Exchange Carriers.* Neither the Commission nor the SBA has developed a definition for small providers of local exchange services. The closest applicable definition under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.³¹ According to the most recent *Telecommunications Industry Revenue* data, 1,348 incumbent carriers reported that they were engaged in the provision of local exchange services.³² We do not have data specifying the number of these carriers that are either dominant in their field of operations, are not independently owned and operated, or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of local exchange carriers that would qualify as small business concerns under the SBA's definition. Of the 1,348 incumbent carriers, 13 entities are price cap carriers that would not be subject to the rules, if adopted. Consequently, we estimate that fewer than 1,335 providers of local exchange service are small entities or small incumbent local exchange carriers that

²⁵ 5 U.S.C. § 603(b)(3).

²⁶ 5 U.S.C. § 601(6).

²⁷ 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632). Pursuant to 15 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."

²⁸ 15 U.S.C. § 632.

²⁹ 5 U.S.C. § 601(3).

³⁰ See Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (May 27, 1999). The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small business." See U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b). Since 1996, out of an abundance of caution, the Commission has included small incumbent LECs in its regulatory flexibility analyses. See, e.g., *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket, 96-98, First Report and Order, 11 FCC Rcd 15499, 16144-45 (1996).

³¹ 13 C.F.R. § 121.201, SIC Code 4813.

³² FCC, Common Carrier Bureau, Industry Analysis Division, *Trends in Telephone Service*, Table 19.3 (March 2000)

may be affected by the proposed Rural Task Force plan.

15. *Competitive Access Providers.* Neither the Commission nor the SBA has developed a definition of small entities specifically applicable to competitive access services providers (CAPs). The closest applicable definition under the SBA rules is for telephone communications companies other than except radiotelephone (wireless) companies.³³ According to the most recent *Trends in Telephone Service* data, 212 CAPs/competitive local exchange carriers and 10 other local exchange carriers reported that they were engaged in the provision of competitive local exchange services.³⁴ We do not have data specifying the number of these carriers that are not independently owned and operated, or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of CAPs that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are less than 212 small entity CAPs and 10 other local exchange carriers that may be affected by the proposed Rural Task Force plan.

16. *Cellular Licensees.* Neither the Commission nor the SBA has developed a definition of small entities applicable to cellular licensees. Therefore, the applicable definition of small entity is the definition under the SBA rules applicable to radiotelephone (wireless) companies. This provides that a small entity is a radiotelephone company employing no more than 1,500 persons.³⁵ According to the Bureau of the Census, only twelve radiotelephone firms from a total of 1,178 such firms which operated during 1992 had 1,000 or more employees.³⁶ Therefore, even if all twelve of these firms were cellular telephone companies, nearly all cellular carriers were small businesses under the SBA's definition. In addition, we note that there are 1,758 cellular licenses; however, a cellular licensee may own several licenses. In addition, according to the most recent *Telecommunications Industry Revenue* data, 808 carriers reported that they were engaged in the provision of either cellular service or Personal Communications Service (PCS) services, which are placed together in the data.³⁷ We do not have data specifying the number of these carriers that are not independently owned and operated or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of cellular service carriers that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are fewer than 808 small cellular service carriers that may be affected by the proposed Rural Task Force plan.

17. *Broadband Personal Communications Service (PCS).* The broadband PCS spectrum is divided into six frequency blocks designated A through F, and the Commission has held auctions for each block. The Commission defined "small entity" for Blocks C and F as an entity that has average gross revenues of less than \$40 million in the three previous calendar years.³⁸ For Block F, an additional classification for "very small business" was added and is defined as an entity that, together with their affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar

³³ 13 C.F.R. § 121.201, SIC code 4813.

³⁴ FCC, Common Carrier Bureau, Industry Analysis Division, *Trends in Telephone Service*, Table 19.3 (March 2000)

³⁵ 13 C.F.R. § 121.201, SIC code 4812.

³⁶ 1992 Census, Series UC92-S-1, at Table 5, SIC code 4812.

³⁷ *Trends in Telephone Service*, Table 19.3 (March 2000).

³⁸ See *Amendment of Parts 20 and 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, WT Docket No. 96-59, Report and Order, FCC 96-278, paras. 57-60 (released June 24, 1996), 61 FR 33859 (Jul. 1, 1996); see also 47 C.F.R. § 24.720(b).

years.³⁹ These regulations defining "small entity" in the context of broadband PCS auctions have been approved by the SBA.⁴⁰ No small businesses within the SBA-approved definition bid successfully for licenses in Blocks A and B. There were 90 winning bidders that qualified as small entities in the Block C auctions. A total of 93 small and very small business bidders won approximately 40% of the 1,479 licenses for Blocks D, E, and F.⁴¹ Based on this information, we conclude that the number of small broadband PCS licensees will include the 90 winning C Block bidders and the 93 qualifying bidders in the D, E, and F blocks, for a total of 183 small entity PCS providers as defined by the SBA and the Commission's auction rules.

18. *Rural Radiotelephone Service.* The Commission has not adopted a definition of small entity specific to the Rural Radiotelephone Service.⁴² A significant subset of the Rural Radiotelephone Service is the Basic Exchange Telephone Radio Systems (BETRS).⁴³ We will use the SBA's definition applicable to radiotelephone companies, *i.e.*, an entity employing no more than 1,500 persons.⁴⁴ There are approximately 1,000 licensees in the Rural Radiotelephone Service, and we estimate that almost all of them qualify as small entities under the SBA's definition.

19. *Specialized Mobile Radio (SMR).* The Commission awards bidding credits in auctions for geographic area 800 MHz and 900 MHz SMR licenses to firms that had revenues of no more than \$15 million in each of the three previous calendar years.⁴⁵ In the context of 900 MHz SMR, this regulation defining "small entity" has been approved by the SBA; approval concerning 800 MHz SMR is being sought.

20. These fees apply to SMR providers in the 800 MHz and 900 MHz bands that either hold geographic area licenses or have obtained extended implementation authorizations. We do not know how many firms provide 800 MHz or 900 MHz geographic area SMR service pursuant to extended implementation authorizations, nor how many of these providers have annual revenues of no more than \$15 million. One firm has over \$15 million in revenues. We assume, for purposes of this IRFA, that all of the remaining existing extended implementation authorizations are held by small entities, as that term is defined by the SBA.

21. For geographic area licenses in the 900 MHz SMR band, there are 60 who qualified as small entities. For the 800 MHz SMR's, 38 are small or very small entities.

22. *Fixed Microwave Services.* Microwave services include common carrier,⁴⁶

³⁹ See *Amendment of Parts 20 and 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, WT Docket No. 96-59, Report and Order, FCC 96-278, para. 60 (1996), 61 FR 33859 (Jul. 1, 1996).

⁴⁰ See, *e.g.*, *Implementation of Section 309(j) of the Communications Act -- Competitive Bidding*, PP Docket No. 93-253, Fifth Report and Order, 9 FCC Rcd 5532, 5581-84 (1994).

⁴¹ FCC News, *Broadband PCS, D, E and F Block Auction Closes*, No. 71744 (released Jan. 14, 1997).

⁴² The service is defined in section 22.99 of the Commission's Rules. 47 C.F.R. § 22.99.

⁴³ BETRS is defined in sections 22.757 and 22.759 of the Commission's Rules. 47 C.F.R. §§ 22.757, 22.759.

⁴⁴ 13 C.F.R. § 121.201, SIC code 4812.

⁴⁵ 47 C.F.R. § 90.814(b)(1).

⁴⁶ 47 C.F.R. §§ 101, *et seq.* (formerly Part 21 of the Commission's Rules).

private-operational fixed,⁴⁷ and broadcast auxiliary radio services.⁴⁸ At present, there are approximately 22,015 common carrier fixed licensees and 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services. The Commission has not yet defined a small business with respect to microwave services. For purposes of this IRFA, we will utilize the SBA's definition applicable to radiotelephone companies -- *i.e.*, an entity with no more than 1,500 persons.⁴⁹ We estimate, for this purpose, that all of the Fixed Microwave licensees (excluding broadcast auxiliary licensees) would qualify as small entities under the SBA definition for radiotelephone companies.

23. *39 GHz Licensees.* Neither the Commission nor the SBA has developed a definition of small entities applicable to 39 GHz licensees. Therefore, the applicable definition of small entity is the definition under the SBA rules applicable to radiotelephone (wireless) companies. This provides that a small entity is a radiotelephone company employing no more than 1,500 persons.⁵⁰ For purposes of the 39 GHz license auction, the Commission defined "small entity" as an entity that has average gross revenues of less than \$40 million in the three previous calendar years, and "very small entity" as an entity that has average gross revenues of not more than \$15 million for the preceding three calendar years.. The Commission has granted licenses to 29 service providers in the 39 GHz service. We do not have data specifying the number of these carriers that are not independently owned and operated or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of 39 GHz licensees that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are no more than 29 39 GHz small business providers that may be affected by the proposed Rural Task Force plan.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

24. The Rural Task Force proposes that rural carriers be given a choice of three different options for disaggregating and targeting per-line universal service support, including high-cost loop support, Long Term Support (LTS), and Local Switching Support (LSS), to wire center cost zones.⁵¹ Path 1 would be available to rural carriers that do not want to target high-cost support. Path 2 would be available to rural carriers that want state commission review and approval of a disaggregation plan. Path 3 would be available to rural carriers interested in self-certifying a method for disaggregating universal service support into a maximum of two cost zones per wire center.⁵² A disaggregation plan filed under

⁴⁷ Persons eligible under Parts 80 and 90 of the Commission's rules can use Private Operational-Fixed Microwave services. See 47 C.F.R. Parts 80 and 90. Stations in this service are called operational-fixed to distinguish them from common carrier and public fixed stations. Only the licensee may use the operational-fixed station, and only for communications related to the licensee's commercial, industrial, or safety operations.

⁴⁸ Auxiliary Microwave Service is governed by part 74 of Title 47 of the Commission's Rules. See 47 C.F.R. Part 74. Available to licensees of broadcast stations and to broadcast and cable network entities, broadcast auxiliary microwave stations are used for relaying broadcast television signals from the studio to the transmitter, or between two points such as a main studio and an auxiliary studio. The service also includes mobile TV pickups, which relay signals from a remote location back to the studio.

⁴⁹ 13 C.F.R. § 121.201, SIC code 4812.

⁵⁰ 13 C.F.R. § 121.201, SIC code 4812.

⁵¹ Under the Rural Task Force's proposal, rural carriers also may disaggregate and target per-line support to cost zones within wire centers.

⁵² Alternatively, the self-certified plan may comply with a prior regulatory determination that a different level of disaggregation is appropriate.

Path 3 must use a rationale that is reasonably related to the cost of providing service for each cost zone within each disaggregation category (high-cost loop support, LSS, and LTS). Rural carriers would be required to choose one of the paths within 270 days of the effective date of the proposed new rules. If these proposals are adopted, rural carriers that elect to disaggregate and target per-line support would be required to report loops at the cost-zone level, which would be a modification of the current requirement that carriers report loops at the study-area level. This change should require only minor increases to a carrier's reporting burdens, and predominantly only in the first year that the carrier revises its method of reporting. We estimate that the annual burden hours in the first year would be 60 hours. We estimate subsequent annual burden hours at 8 hours. We believe the burden associated with this proposed reporting requirement is appropriately balanced with the benefits reporting rural carriers would receive.

25. The Rural Task Force also proposes extension of the section 254(e) certification process to rural carriers.⁵³ Under this process, state regulatory commissions would provide the Commission with annual certifications indicating that the carriers in their states receiving federal universal service support will use the support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."⁵⁴ This reporting requirement would provide states and carriers with access to federal universal service support in a way that ensures the integrity of the universal service fund. We estimate that the annual burden hours associated with the section 254(e) certification process would be 12 hours per carrier. This is a nominal burden on rural carriers and is balanced against the high degree of federal universal service benefits rural carriers would receive.

5. Steps Taken To Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

26. The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.⁵⁵

27. The Rural Task Force Recommendation under consideration herein is the product of analysis of a number of options for distributing federal universal service support to rural carriers, including the continuation or modification of the current system of support, a system of support based on forward-looking cost models, competitive bidding approaches, rate buy-down mechanisms, and a melded approach combining aspects of both the current, embedded-cost system and a forward-looking support system.⁵⁶ The results of the Rural Task Force's evaluation of these various options are set forth in the third and fourth White Papers prepared by the Rural Task Force.⁵⁷ The Rural Task Force ultimately recommended the modified version of the current high-cost loop support mechanism based on carriers'

⁵³ 47 U.S.C. § 254(e).

⁵⁴ *Id.*

⁵⁵ 5 U.S.C. § 603(c).

⁵⁶ See *Recommended Decision*, FCC 00J-4 at Appendix A, §§ III(A), III(B).

⁵⁷ See *id.* at 17. The Rural Task Force White Papers are available on the Rural Task Force web site at www.wutc.wa.gov/rtf/rtfpub.nsf?open.

embedded costs set forth in its Recommendation.

28. Alternatives to the proposed adoption of the Rural Task Force Recommendation include continuation of the current high-cost loop support mechanism for rural carriers, developing a new support mechanism based on forward-looking economic costs, or adopting specific aspects of the Rural Task Force Recommendation instead of adopting the Recommendation as a whole. We invite comment on how any of these alternatives, or any other alternatives discussed herein, would be likely to affect small businesses.

6. Federal Rules That May Duplicate, Overlap, or Conflict With the Proposed Rules

29. None.

C. Paperwork Reduction Act

30. As part of our continuing effort to reduce paperwork burdens, we invite the general public to take this opportunity to comment on information collections contained in this Further Notice, as required by the Paperwork Reduction Act of 1995, Pub. L. No. 104-13. Public and agency comments are due at the same time as other comments on this Further Notice. 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 forms of information technology.

V. COMMENT FILING PROCEDURES

31. 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 30 days or fewer from publication in the Federal Register, and reply comments 45 days or fewer from publication in the Federal Register. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.⁵⁸

32. 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.

33. 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 12th Street, S.W., Washington, D.C. 20554.

⁵⁸ See Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24,121 (1998).

34. Parties who choose to file by paper should also submit their comments on diskette. These diskettes should be submitted to: Sheryl Todd, Accounting Policy Division, 445 12th Street, S.W., Washington, D.C. 20554. Such a submission should be on a 3.5-inch diskette formatted in an IBM compatible format using Word or compatible software. The diskette should be accompanied by a cover letter and should be submitted in "read only" mode. The diskette should be clearly labeled with the commenter's name, proceeding (including the docket number, in this case CC Docket No. 96-45, type of pleading (comment or reply comment), date of submission, and the name of the electronic file on the diskette. The label should also include the following phrase "Disk Copy - Not an Original." Each diskette should contain only one party's pleadings, preferably in a single electronic file. 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.

35. Written comments by the public on the proposed and/or modified information collections are due on or before thirty days after the date of publication in the Federal Register. Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed and/or modified information collections on or before 60 days after date of publication in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judy Boley, Federal Communications Commission, Room 1-C804, 445 12th Street, S.W., Washington, DC 20554, or via the Internet to jboley@fcc.gov and to Edward Springer, OMB Desk Officer, 10236 NEOB, 725 - 17th Street, N.W., Washington, D.C. 20503.

VI. ORDERING CLAUSES

36. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 4(i), 4(j), 201-205, 254, and 403 of the Communications Act of 1934, as amended,⁵⁹ this Further Notice of Proposed Rulemaking IS ADOPTED.

37. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Further Notice of Proposed Rulemaking, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

⁵⁹ 47 U.S.C. §§ 154(i), 154(j), 201-205, 254, and 403.

APPENDIX A:

**Federal-State Joint Board on Universal Service
Recommended Decision Concerning
Rural Task Force Recommendation**

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

In the Matter of)	
)	
Federal-State Joint Board on)	CC Docket No. 96-45
Universal Service)	
)	

RECOMMENDED DECISION

Adopted: December 22, 2000

Released: December 22, 2000

By the Federal-State Joint Board: Commissioners Ness, Furtchgott-Roth, and Tristani issuing separate statements; Commissioners Schoenfelder and Rowe concurring and issuing separate statements; Public Counsel Hogerty concurring in part and dissenting in part and issuing a separate statement; Chairman Wood issuing a statement at a later date.

I. INTRODUCTION

1. In this Recommended Decision, we send to the Commission the Rural Task Force Recommendation that can serve as a good foundation for implementing a rural universal service plan that benefits consumers. Generally, we find that the Rural Task Force sought to achieve the goals of the Telecommunications Act of 1996 to preserve and advance universal service, facilitate competition in rural areas, and provide a predictable level of universal service support.¹ Moreover, we believe that implementation of the Rural Task Force's framework would provide a stable environment for rural carriers to invest in rural America.

II. BACKGROUND

A. Statutory Requirements

2. In the 1996 Act, Congress established a number of principles for the preservation and advancement of universal service in a competitive telecommunications environment. In particular, section 254 of the 1996 Act provides that consumers in all regions of the Nation, including consumers in rural, insular, and high-cost areas, should have access to telecommunications services at rates that are affordable and reasonably comparable.² Section 254 also provides that access to advanced telecommunications and information services should be provided in all regions of the Nation, and that federal universal service support mechanisms should be specific, predictable, and sufficient to preserve and advance universal service.³ The Commission adopted the additional principle that federal support mechanisms should be competitively neutral, neither unfairly advantaging nor disadvantaging particular

¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151, *et seq.*

² 47 U.S.C. § 254(b)(3).

³ *Id.* at §§ 254(b)(2), (5).

service providers or technologies.⁴ Federal universal service policies should strike a fair and reasonable balance among these principles or goals enumerated in section 254 of the 1996 Act.⁵ The 1996 Act also requires the Commission to consult with the Federal-State Joint Board on Universal Service (Joint Board) in implementing section 254.⁶

B. Prior Joint Board and Commission Actions

3. Pursuant to the 1996 Act, the Joint Board provided its first set of recommendations regarding universal service to the Commission in November 1996.⁷ Based on these recommendations, the Commission adopted the *First Report and Order* in May 1997.⁸ Among other things, the Commission concluded that federal universal service support for all carriers, both rural and non-rural,⁹ should be based on the forward-looking economic cost of constructing and operating the network used to provide the supported services, rather than each carrier's embedded costs.¹⁰ The Commission explained that using forward-looking economic costs provides sufficient support without giving carriers an incentive to inflate their costs or to refrain from efficient cost cutting.

4. Nevertheless, the Commission adopted the Joint Board's recommendation that rural carriers not use a cost model or other means of determining forward-looking economic cost immediately to calculate their support for serving rural high-cost areas.¹¹ The Commission agreed with the Joint Board that, compared to the large non-rural carriers, "rural carriers generally serve fewer subscribers, serve more sparsely populated areas, and do not generally benefit as much from economies of scale and scope. For many rural carriers, universal service support provides a large share of the carriers' revenues, and thus,

⁴ See *id.* at § 254(b)(7); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8801-03 paras. 46-51 (1997) (*First Report and Order*) (subsequent history omitted).

⁵ *First Report and Order*, 12 FCC Rcd at 8803 para. 52.

⁶ See 47 U.S.C. § 254(a).

⁷ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87 (Jt. Bd. 1996) (*First Recommended Decision*).

⁸ *First Report and Order*, 12 FCC Rcd 8776.

⁹ "Rural carriers" are local exchange carriers (LECs) that meet the definition of a rural telephone company contained in section 153(37) of the 1996 Act, and "non-rural carriers" are LECs that do not meet this definition. 47 U.S.C. § 153(37).

¹⁰ *First Report and Order*, 12 FCC Rcd at 8899-901 paras. 224-229. At the time of the *First Report and Order*, three federal universal service support mechanisms provided support for rural and non-rural carriers, for the most part based on embedded costs averaged over entire study areas. The high-cost loop support and Local Switching Support (formerly DEM Weighting) programs under Part 36 of the Commission's rules provided support for intrastate-allocated costs. See *infra* notes 21-22. The Long Term Support program provided support for interstate-allocated costs. See *infra* note 22. These three support mechanisms currently provide approximately \$1.568 billion in annual high-cost support to over 1,300 rural carriers. See Letter from D. Scott Barash, Vice President and General Counsel, Universal Service Administrative Company (USAC), to Magalie Roman Salas, FCC, dated November 2, 2000, at Appendix HC 3 (USAC 1st Quarter 2001 Projections). The Commission's new, forward-looking high-cost support mechanism for non-rural carriers became effective on January 1, 2000. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20439 (1999) (*Ninth Report and Order*), *pets. for review pending sub nom., Qwest Corp. v. FCC*, 10th Cir. No. 99-9546 and consolidated cases (1999).

¹¹ *First Report and Order*, 12 FCC Rcd at 8934 para. 291.

any sudden change in the support mechanisms may disproportionately affect rural carriers' operations."¹² Accordingly, working with rural carriers and their associations, the Commission stated that it would not implement forward-looking support for rural carriers before January 1, 2001, and only after selecting an appropriate high-cost support mechanism based on recommendations from the Joint Board and a Rural Task Force appointed by the Joint Board.¹³ In recommending a proxy model as a framework for determining non-rural carrier high-cost support, the Joint Board emphasized that it did "not intend for the Commission to create any precedent for any potential revisions to support mechanisms for rural carriers."¹⁴ In this regard, the Commission agreed with the state Joint Board members that a task force "should provide valuable assistance in identifying the issues unique to rural carriers and analyzing the appropriateness of proxy cost models for rural carriers."¹⁵

C. Rural Task Force Recommendation

5. The Joint Board announced the creation of the Rural Task Force in September 1997, and appointed the Rural Task Force members in July 1998.¹⁶ The Joint Board requested that the Rural Task Force provide its recommendations no later than nine months after the implementation of the forward-looking high-cost mechanism for non-rural carriers, which became effective on January 1, 2000.¹⁷ Accordingly, the Rural Task Force presented its Recommendation to the Joint Board on September 29, 2000.¹⁸ The Recommendation represents the consensus of individual Rural Task Force members, who work for a broad range of interested parties, including rural telephone companies, competitive local exchange carriers, interexchange carriers, wireless providers, consumer advocates, and state and federal government agencies. The Rural Task Force offers its Recommendation as an integrated package, and asks that it be adopted without modification. It urges that the Recommendation be implemented immediately and remain in place over a five-year period. The Recommendation is attached as Appendix A to this Recommended Decision.¹⁹ Below, we summarize salient features of the Recommendation.

6. The Rural Task Force recommends against using the Commission's forward-looking high-cost mechanism for non-rural carriers to distribute high-cost support for rural carriers.²⁰ Instead, it recommends the use over the next five years of a modified version of the current high-cost loop support

¹² *Id.* at 8936 para. 294.

¹³ *Id.* at 8917 para. 252-53, 8936 para. 294.

¹⁴ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Second Recommended Decision, 13 FCC Rcd 24744 at 24758 para. 30 (Jt. Bd. 1998) (Second Recommended Decision).

¹⁵ *Id.* at 8917 para. 253; *see also id.* at para. 255; *Second Recommended Decision*, 13 FCC Rcd 24744 at para. 30 (Jt. Bd. 1998).

¹⁶ *See Federal-State Joint Board on Universal Service Announces Rural Task Force Members*, CC Docket No. 96-45, Public Notice, FCC 98J-1 (Jt. Bd. rel. July 1, 1998); *Federal-State Joint Board on Universal Service Announces the Creation of a Rural Task Force*, CC Docket No. 96-45, Public Notice, 12 FCC Rcd 15752 (Jt. Bd. 1997).

¹⁷ *See id.*

¹⁸ Letter from William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, dated September 29, 2000 (Rural Task Force Recommendation or Recommendation).

¹⁹ Appendix A; *see also* Rural Task Force web site at www.wutc.wa.gov/rtf/rtfpub.nsf?open.

²⁰ The Rural Task Force emphasizes that its Recommendation applies only to rural, insular, and high-cost areas served by rural carriers, and not to areas served by non-rural carriers. *See* Appendix A at 18.

mechanism under Part 36 of the Commission's rules, based on carriers' embedded costs.²¹ In addition, the Rural Task Force recommends continuation of the Long Term Support (LTS) and Local Switching Support (LSS) programs.²²

7. The Rural Task Force's proposed modifications to the high-cost loop support mechanism include various upward adjustments to current limits on universal service support for rural carriers, including (a) recomputing the indexed cap on high-cost loop support²³ and the corporate operations expense limitation²⁴ as if the caps had not been in effect for the calendar year 2000,²⁵ (b) providing above-the-cap "safety net additive" support for carriers with over 14 percent growth in telecommunications plant in service on a per-line basis, and (c) creating a "safety valve" to provide additional support for "meaningful investment" in acquired telephone exchanges.²⁶ The Rural Task Force also recommends that per-line universal service support payment levels within a study area become fixed once a competitive

²¹ High-cost loop support under Part 36 provides support for a variable percentage of carriers' unseparated loop costs, as reflected in their books, depending on the number of working loops they serve and the degree to which their costs exceed the national average cost per loop. See 47 C.F.R. §§ 36.601, *et. seq.*; *First Report and Order*, 12 FCC Rcd at 8891-92 paras. 209-11. Specifically, carriers with 200,000 or fewer working loops receive support equal to 65 percent of that portion of their unseparated loop costs exceeding 115 percent of the national average but not greater than 150 percent of the national average, and 75 percent of that portion of their unseparated loop costs exceeding 150 percent of the national average. For carriers with greater than 200,000 working loops, the formula is similar, but with reduced levels of support. For example, a carrier with 200,001 loops reaches the 75 percent support level only for costs that are greater than 250 percent of the national average. The national average is calculated based on the loop costs of both rural and non-rural carriers. The term "unseparated" refers to costs as calculated before applying the jurisdictional separations process, which divides between the state and federal jurisdictions the costs of those portions of local exchange carriers' telephone plant that are used for intrastate and interstate services. See 47 C.F.R. § 36.631.

²² LTS provides support for the interstate-allocated loop costs of rate-of-return carriers (typically small rural carriers) that participate in the National Exchange Carrier Association (NECA) common line pool, and LSS (formerly DEM Weighting) is available to support the intrastate switching costs of carriers with 50,000 or fewer loops. 47 C.F.R. §§ 36.125(b), 54.301, 54.303. The Commission removed LTS and LSS, as well as high-cost loop support under Part 36, from the interstate access charge system in 1997, and they are now collected from all providers of interstate telecommunications services on an equitable and non-discriminatory basis. See *generally Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourth Order on Reconsideration, *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, Report and Order, 13 FCC Rcd 5318, 5343-45 paras. 40-41, 5352-54 paras. 56-58 (1998) (*Fourth Order on Reconsideration*).

²³ An indexed cap that limits the increase in support each year to the annual nationwide growth in loops restricts total high-cost loop support under Part 36 of the Commission's rules. See 47 C.F.R. Part 36, Subpart F; *First Report and Order*, 12 FCC Rcd at 8940 para. 302 ("indexed cap effectively limits the overall growth of the fund, while protecting individual carriers from experiencing extreme reductions in support").

²⁴ The Commission's rules limit the amount of corporate operations expenses that carriers may recover through high-cost loop support under Part 36. See 47 C.F.R. § 36.621; *First Report and Order*, 12 FCC Rcd at 8930-32 paras. 283-85.

²⁵ The Rural Task Force estimates that this particular proposal would increase the size of the high-cost loop support fund by approximately \$118.5 million in the first year, representing \$83.9 million in additional high-cost loop support and \$34.6 million in additional support for corporate operations expenses. For Rural Task Force estimates of the potential cost of other aspects of its Recommendation, see Letter from William R. Gillis, Rural Task Force, to Magalie Roman Salas, FCC, dated November 10, 2000.

²⁶ Section 54.305 of the Commission's rules currently limits universal service support for acquired exchanges to the per-line support received by the seller. 47 C.F.R. § 54.305.

eligible telecommunications carrier begins providing service in the study area, and subsequently adjusted for growth in lines and inflation rather than changes in cost. Under the Rural Task Force's proposal, "safety net additive" support, support for acquired exchanges and "safety valve" support, support for competitive eligible telecommunications carriers, and catastrophic event support²⁷ would be excluded from the cap on high-cost loop support. Total "safety valve" support would be limited to five percent of the overall cap.

8. The Rural Task Force also recommends the use of a new annual index known as the "rural growth factor" to adjust the cap on high-cost loop support, the corporate operations expense limitation, and fixed per-line support (in areas where competitive carriers are providing service) on a going-forward basis. The rural growth factor would be the sum of annual line growth for rural carriers and a general inflation factor (Gross Domestic Product-Chained Price Index).

9. The Rural Task Force suggests various other reforms. Among other things, it proposes that rural carriers be given a choice of three different options for disaggregating and targeting per-line universal service support, to be exercised within 270 days of the effective date of the proposed new rules. Furthermore, the Rural Task Force recommends adoption of a "no barriers to advanced services" policy, and suggests a number of principles for replacing any implicit subsidies in interstate access charges with explicit universal service support.²⁸

III. DISCUSSION

10. The Rural Task Force faced a challenging task. Congress recognized that, while competition could encourage investment in rural infrastructure and bring new, improved services to rural America, special measures were required to preserve and advance universal service. In several areas, Congress provided separate rules for markets served by small, rural telephone companies.²⁹ Accordingly, in implementing the 1996 Act, the Joint Board and the Commission have consistently recognized that rural carriers face diverse circumstances and that, in considering universal service support mechanisms, "one size does not fit all." The Rural Task Force thus was charged with the task of considering the needs of rural carriers.³⁰ The Rural Task Force recommends a flexible plan designed to balance competing goals, a

²⁷ Under the Rural Task Force Recommendation, fixed per-line support in areas where competitive carriers are providing service would be subject to adjustment by the incumbent carrier to recover costs associated with catastrophic events.

²⁸ We note that the Multi-Association Group (MAG) recently submitted to the Commission a comprehensive proposal for interstate access charge and universal service reform for rate-of-return carriers. *Petition for Rulemaking of the LEC Multi-Association Group*, RM 10011 (filed October 20, 2000) (*MAG Plan*); see *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd 14238 (1998). The MAG is comprised of the National Rural Telecom Association (NRTA), National Telephone Cooperative Association (NTCA), Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), and United States Telecom Association (USTA).

²⁹ For example, the 1996 Act provides that state commissions may designate more than one eligible telecommunications carrier in an area served by a rural telephone company, but only after determining that such additional designation is in the public interest. See 47 U.S.C. § 214(e)(2). In addition, states may require a telecommunications carrier that seeks to provide service in a rural telephone company's service area to meet the eligible telecommunications carrier requirements of section 214(e)(1). See 47 U.S.C. §§ 214(e)(1), 253(f).

³⁰ See *Federal-State Joint Board on Universal Service Announces Rural Task Force Members*, CC Docket No. 96-45, Public Notice, FCC 98J-1 (Jt. Bd. rel. July 1, 1998); *Federal-State Joint Board on Universal Service*

plan that was endorsed by all the members of the Task Force. We find it significant that the Recommendation represents a consensus of competing views. We encourage the Commission to take advantage of this opportunity to craft a rural universal service plan that enjoys widespread support among diverse interests.

11. The Recommendation preserves a predictable level of universal service support that will provide stability to rural carriers – incumbents and competitors – for planning their investments over the next several years. By recommending a flexible system for disaggregating support to establish the portable per-line support amount available to all eligible telecommunications carriers, the Rural Task Force seeks to encourage competitors to enter high-cost areas. In addition, the Rural Task Force recommends certain modifications to the caps and limitations on high-cost loop support. These modifications are generally designed to provide carriers serving rural areas with increased incentives to invest in new infrastructure and technologies. Under the current mechanism, high-cost loop support for rural carriers is estimated to be \$835 million in 2001. The Rural Task Force estimates that, under its Recommendation, high-cost loop support for rural carriers will be \$961 million in 2001 and increase to \$1.29 billion in 2005.³¹ The Rural Task Force thus proposes to increase the rural high-cost loop fund by \$1.26 billion in the aggregate over the proposed five-year period, compared to the projected growth under the current mechanism.³²

12. In determining federal support for non-rural carriers, the Joint Board previously has recognized its obligation to provide sufficient support to ensure affordable and comparable rates. The Rural Task Force has noted that the 1996 Act sets standards to provide sufficient support while preventing “waste, windfall, and excessive expense for contributing carriers and their customers.”³³ While a significant number of commenters urge the Joint Board to recommend the Rural Task Force plan without modification,³⁴ other commenters, including some rural carriers, believe that the Rural Task

Announces the Creation of a Rural Task Force, CC Docket No. 96-45, Public Notice, 12 FCC Rcd 15752 (Jt. Bd. 1997).

³¹ See Letter from William R. Gillis, Rural Task Force, to Magalie Roman Salas, FCC, dated November 10, 2000. The Rural Task Force support estimates include only high-cost loop support. In addition, based on USAC’s first quarter 2001 projections, rural carriers will receive \$386 million in LSS, \$390 million in LTS, and \$52 million in interstate access support. See USAC 1st Quarter 2001 Projections. These amounts also do not include implicit universal service support that may be included in rural carrier interstate access charges. The Rural Task Force recommends that LSS and LTS remain in place for the duration of its proposed plan and does not comment on the existing interstate access support program for price cap companies.

³² Joint Board staff estimate the \$1.26 billion increase as the difference between the Rural Task Force estimates and projected high-cost loop support based on the current rules. Staff derived current rule estimates by increasing the 2001 rural high-cost loop support estimate of \$835 million, reported in USAC’s first quarter 2001 projections, by 2.86 percent annual industry line growth factor, as reported in the NECA October 2000 filing. See NECA Universal Service Fund 2000 Submission of 1999 Study Results, filed October 1, 2000.

³³ See Appendix A at 8.

³⁴ See, e.g., CenturyTel Comments at 1-2 (urging the Joint Board to act quickly because “[r]eform is critically needed”); Evans Comments at 2 (“The Task Force Recommendation to the Joint Board is the first comprehensive proposal for implementation of the policies and principles of the 1996 Act on the subject of universal service support for high-cost [rural carriers] that includes input of and support by a broad base of interested stakeholders.”); GVNW Comments at 3 (“With the record now developed by a group representing the spectrum of those impacted by rural universal service public policy, it is now time to implement these recommendations for a five year-period.”). NECA Comments at 8-9 (“The RTF Recommendation should be adopted immediately by the

Force Recommendation would provide too little support.³⁵ Still other commenters, including several state commissions and carriers, believe it would provide too much support.³⁶ We believe that the nature of these comments is consistent with a recommendation that is a consensus proposal put forth by representatives of disparate interests.

13. The Rural Task Force has proceeded with caution by proposing modifications to the current embedded cost system for a five-year period, rather than attempting to modify the Commission's forward-looking cost mechanism that currently is used to determine non-rural support. We agree with the Rural Task Force that understanding the diversity among rural carriers and the differences between small rural carriers and large carriers is desirable in designing appropriate universal service support mechanisms. The Rural Task Force provided valuable data on these differences in their second White Paper, "The Rural Difference."³⁷ Specifically, the Rural Task Force demonstrated the inappropriateness of using input values designed for non-rural carriers to determine support for rural carriers.³⁸ We urge the Commission to use the period during which a Rural Task Force Recommendation is in place to develop a long-term universal service plan that better targets support to rural companies serving the highest cost areas. The Joint Board should remain involved in the process to develop improvements to the rural system. We also urge the Commission to evaluate the rural and non-rural support systems to ensure they work together efficiently, while at the same time recognizing the significant distinctions among rural carriers and between rural and non-rural carriers.³⁹ In sum, we conclude that the Rural Task Force Recommendation presents a good foundation for implementing a rural universal service plan.

14. We observe that the Recommendation proposes modifications to the Commission's rules that involve specific implementation details that the Commission may need to address. Below, we highlight some of these implementation issues.

Joint Board and the Commission, with due consideration of the potential longer-term effects of imposing artificial limits, such as continuation of any form of capping, on the size of the Rural carrier high cost fund.").

³⁵ See, e.g., Citizens Comments at 2-5 ("proposal to 'right size' the fund by ameliorating the impact of the past cap suggests the imposition of a new cap might necessitate . . . a new right sizing in order to achieve the intended result of spurring investment in rural America"); MTA Comments at 3 (arguing that loss of \$130 million due to caps "is money that could have been directly invested in our telecommunications infrastructure"); NTCA Comments at 7-10 (strongly believes that no caps on the universal service support funds should be retained and that caps are unlawful); USTA Comments at 6-8 (opposing any cap on the rural high-cost fund to ensure sufficiency as mandated by section 254(b)(5) of the Act).

³⁶ See, e.g., Charter Comments at 6-10 ("reform of rural universal service should be about reform, not about tweaking a subsidy structure that is outmoded and antithetical to competition"); New York Comments at 3-4 (no showing that total amount of support recommended would be only that amount necessary to enable rates to establish reasonably comparable rates); WorldCom Comments at 5-8 ("no evidence that rural LECs have been unable to maintain their quality of service or upgrade facilities at the support levels provided by the existing mechanisms"); Ad Hoc Reply Comments at 13-14 ("any increase or elimination of the indexed cap on the [high-cost loop] fund would only encourage a rural carrier to make inefficient investment decisions").

³⁷ See Rural Task Force, *White Paper 2: The Rural Difference* (January 2000) (*White Paper 2*), which is available on the Rural Task Force's web site at www.wutc.wa.gov/rtf/rtfpub.nsf?open.

³⁸ See, *id.*; see, e.g., GCI Comments at 2-3; People Comments at 2-3; WorldCom Comments at 2; Ad Hoc Reply Comments at 5-6; AT&T Reply Comments at 3-4.

³⁹ See *White Paper 2* at www.wutc.wa.gov/rtf/rtfpub.nsf?open.

A. Mergers and Acquisitions Cap & the “Safety Valve” Mechanism

15. Section 54.305 of the Commission’s rules provides that a carrier acquiring exchanges from an unaffiliated carrier shall receive the same per-line levels of high-cost universal service support for which the acquired exchanges were eligible prior to their transfer.⁴⁰ The Rural Task Force recommends that the Commission retain section 54.305 of its rules, but establish an appropriate “safety valve” mechanism to enable rural carriers acquiring access lines eligible for high-cost loop support to recover additional support reflecting “meaningful investment” in acquired access lines.⁴¹ The Rural Task Force provides an illustration of such a mechanism in Appendix D of its Recommendation.⁴² In Appendix D, the Rural Task Force defines “meaningful investment” for purposes of qualifying a rural carrier for “safety valve” support as the difference between the “index year expense adjustment” calculated in accordance with section 36.631 of the Commission’s rules⁴³ and subsequent year expense adjustments.⁴⁴ The Rural Task Force’s example also proposes to limit the total “safety valve” support available to all eligible study areas to no more than five percent of the indexed high-cost loop fund cap for rural carriers.⁴⁵

16. We support the Rural Task Force’s proposal for providing additional support to rural carriers that acquire high-cost exchanges and make post-transaction investments to enhance the network infrastructure. We note, however, that the Task Force’s proposal does not address a number of important implementation issues. In order to ensure effective implementation of the “safety-valve” mechanism, we encourage the Commission to address several implementation issues. First, the Commission should consider the distribution of “safety valve” support if the total amount of eligible “safety valve” support exceeds the cap of five percent of the indexed high-cost loop support fund.⁴⁶ The Commission should also examine the definition of “meaningful investment.”⁴⁷ In addition, the Commission should address whether a carrier’s “safety valve” support should transfer to a different carrier as a result of a subsequent transfer of exchanges. Finally, the Commission should consider whether “safety valve” support is “frozen” when a competitive eligible telecommunications carrier enters the study area, just as other high-cost loop support would be frozen when a competitive eligible telecommunications carrier enters the incumbent’s service area, and whether such an approach would unduly dissuade investment.

⁴⁰ 47 C.F.R. § 54.305. High-cost support mechanisms currently include non-rural carrier forward-looking high-cost support, interim hold-harmless support for non-rural carriers, rural carrier high-cost loop support, local switching support, and Long Term Support (LTS). See 47 C.F.R. §§ 36.601-36.631, 54.301, 54.303, 54.309, 54.311.

⁴¹ See Appendix A at 29.

⁴² See *id.* at Appendix D.

⁴³ See 47 C.F.R. § 36.631.

⁴⁴ See Appendix A at Appendix D-1.

⁴⁵ See *id.*

⁴⁶ See, e.g., USTA Comments at 9-10 (arguing that increased support resulting from a single transfer could exceed the five percent cap).

⁴⁷ For example, it may be more appropriate to define “meaningful investment” so that the “index year expense adjustment” is the year prior to the subsequent year “expense adjustment.” As currently proposed, the “index year expense adjustment” is the study area’s high-cost loop support “expense adjustment” calculated at the end of the acquiring company’s first year of operations.

B. Support in Competitive Study Areas

17. As discussed above, the Rural Task Force recommends that the Commission “freeze” per-line high-cost loop support directed to a rural study area if a competitive eligible telecommunications carrier has been designated and begins providing service in that study area.⁴⁸ Under the Rural Task Force’s proposal, both the incumbent LEC and the competitive eligible telecommunications carrier would receive fixed per-line support. The Rural Task Force also recommends that the Commission increase such fixed per-line support by the Rural Task Force’s proposed Rural Growth Factor.⁴⁹ Although we agree with the Rural Task Force that the Commission should “freeze” per-line high-cost loop support when a competitor begins providing services in a given study area, it is unclear how the high-cost loop fund cap would account for fixed rural carrier support. The Commission should seek additional input from commenters, including the Rural Task Force, on the operation of the high-cost loop fund cap on fixed rural carrier support.

18. The Rural Task Force also recommends that the Commission permit incumbent LECs receiving “frozen” per-line high-cost to adjust frozen per-line support to recover costs associated with catastrophic events affecting the carrier’s ability to provide supported services.⁵⁰ The Commission should seek further input on the impact of “catastrophic” support provided by other sources such as insurance, Rural Utilities Service loans, and federal or state emergency management relief.⁵¹

C. The “Safety Net Additive”

19. In years in which the Rural Task Force’s new indexed cap on the high-cost loop support fund is triggered and growth in telecommunications plant in service (TPIS) per line in a rural study area is at least 14 percent greater than the study area’s TPIS per line in the prior year, the Rural Task Force proposes a “safety net additive,” which would enable a carrier to recover 50 percent of the difference between capped and uncapped support.⁵² Any study area that qualifies for the safety net additive support also would qualify for safety net additive support in each of the four succeeding years, regardless of whether the study area meets the 14 percent criterion in those years.⁵³ Safety net additive support would be in addition to capped high-cost loop support, and would not be subject to the Rural Task Force’s new indexed cap on such support.⁵⁴ We agree with the Rural Task Force that additional support in the form of a safety net additive should be available to rural carriers that make significant investment in rural infrastructure, but urge the Commission to seek further comment on whether the safety net additive mechanism enables a carrier to recover more than 100 percent reimbursement on incremental loop investment.⁵⁵

⁴⁸ See Appendix A at 26.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ See Sprint Comments at 3 (“fund should not become substitute for carriers’ insurance policies”).

⁵² See Appendix A at 27.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ See, e.g., Bristol Comments at 3; TDS Telecom Comments at 8.

D. Interstate Access Universal Service Support for Non-Price Cap Carriers

20. The Rural Task Force recommends that the Commission replace implicit universal service support included in rural carrier interstate access charges with an uncapped "High Cost Fund III."⁵⁶ The Rural Task Force also articulates several principles that the Commission should follow in implementing that task.⁵⁷ We concur with the Rural Task Force that the Commission should consider creating an explicit universal service support mechanism to replace support that may be implicit within interstate access charges collected by rural carriers.⁵⁸ We acknowledge, however, that the access charge issues raised by the Rural Task Force and the MAG are interstate in nature and, therefore, are properly before the Commission.⁵⁹ However, the MAG plan raises issues beyond interstate access reform, and proposes universal service policy and procedural changes, including rate comparability under section 254(b)(3) and the overall size of the universal service mechanisms. Section 254(b) and 254(c) of the 1996 Act both contemplate that the Joint Board remain involved in matters related to universal service.⁶⁰ We therefore encourage the Commission to ensure the Joint Board remains actively involved in review of those aspects of the MAG plan that relate to universal service. A significant number of Joint Board members urge that this involvement include a referral to the Joint Board of the universal service issues raised by the MAG plan.

E. Future Steps

21. As discussed above, the Rural Task Force urges that its recommendation be implemented immediately and remain in place over a five-year period.⁶¹ In addition to the Commission's ongoing consultation with the Joint Board during this period, we urge the Commission to refer to the Joint Board, no later than January 1, 2002, a proceeding to consider implementation of an appropriate high-cost mechanism for rural carriers after the expiration of the Rural Task Force's plan. We note that the Commission and the Joint Board are already committed to review the operation of the high-cost support mechanism for non-rural carriers on or before January 1, 2003.⁶² This proposed timing would permit the Joint Board and the Commission to consider the appropriate rural mechanism to succeed the plan that the Commission adopts pursuant to the Rural Task Force's recommendation and devote sufficient time to the task prior to the termination of that plan. We also recommend eventual comprehensive review of the high-cost support mechanisms for rural and non-rural carriers as a whole to ensure that both mechanisms function efficiently and in a coordinated fashion. We urge the Commission to use the transitional period during which a modified embedded cost mechanism is in place to develop a long-term universal service

⁵⁶ See Appendix A at 30-32.

⁵⁷ See *id.*

⁵⁸ See AT&T Comments at 5-6; CenturyTel Comments at 2; NTCA Comments at 18; Roseville Comments at 4; TDS Telecom Comments at 6-7.

⁵⁹ See NTCA Comments at 19; Roseville Comments at 4; TDS Telecom Comments at 6-7; USTA Comments at 11.

⁶⁰ See 47 U.S.C. §§ 254(b), (c).

⁶¹ See *supra* discussion at para. 5.

⁶² *Federal-State Joint Board on Universal Service, Access Charge Reform*, CC Docket Nos. 96-45, 96-262, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8077, 8123 para. 94 (1999).

plan that better targets support to rural companies serving the highest cost areas, while at the same time recognizing the significant distinctions among rural carriers and between rural and non-rural carriers.

IV. RECOMMENDING CLAUSE

22. For the reasons discussed herein, the Federal-State Joint Board on Universal Service, pursuant to section 254(a)(1) and section 410(c) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 254(a)(1), 410(c), recommends that the Commission adopt the Rural Task Force Recommendation as a foundation for implementing a rural universal service plan.

FEDERAL COMMUNICATIONS COMMISSION



Magalie Roman Salas
Secretary

APPENDIX A

**RURAL TASK FORCE
RECOMMENDATION TO
THE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE**

RURAL TASK FORCE RECOMMENDATION

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

In the Matter of)
)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

**RURAL TASK FORCE
RECOMMENDATION TO THE FEDERAL-STATE JOINT BOARD
ON UNIVERSAL SERVICE**

Adopted: September 22, 2000

Released: September 29, 2000

By the Rural Task Force:

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RURAL TASK FORCE RECOMMENDATION

I. EXECUTIVE SUMMARY

This document contains a comprehensive, balanced package that is the final Recommendation (Recommendation) of the Rural Task Force (Task Force). The Task Force was appointed by the Federal-State Joint Board on Universal Service (Joint Board) in CC Docket No. 96-45 pursuant to the Telecommunications Act of 1996 (1996 Act).¹ We urge that the Recommendation be implemented immediately and remain in place for five years. Plans should be made to reevaluate appropriate universal service funding approaches for areas served by "rural telephone companies"² prior to the end of the five-year period. The Recommendation represents the consensus of individual Task Force members.³ The Recommendation may or may not represent the positions of organizations or companies to which Task Force members belong.

The Task Force has expended considerable time over the past two years in learning, discussing, debating, negotiating, and compromising to develop this Recommendation. As a delicately-crafted package, it is meant to balance the mandate to preserve and advance universal service while at the same time facilitating competition in areas served by Rural Carriers. The Recommendation also strikes a careful balance between the need to provide a fund that is "sufficient" under the provisions of the 1996 Act while insuring that the overall size of the fund is reasonable. Each of the elements of this comprehensive package are interdependent and should be considered in concert with each other, and should be implemented expeditiously. The Task Force strongly recommends that this balance be honored in reviewing the complete package that comprises its Recommendation.

¹ Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). The 1996 Act amended the Communications Act of 1934, 47 U.S.C. Section 151 *et seq.* (1996 Act).

² "Rural telephone company" means a local exchange carrier operating entity 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 (47 U.S.C. Section 153 (37)). The term "Rural Carrier" as used in this Recommendation is meant to include carriers serving insular areas and to incorporate the statutory definition of "rural telephone company" as applied in the FCC rules. *See In re: Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report and Order* (rel. May 8, 1997) at paragraph 96. *See also FCC Public Notice*, CC Docket No. 96-45, DA 98-1205 (rel. June 22, 1998) lists recognized self-certified "Rural Telephone Companies." This list is updated periodically. *See for example, FCC Public Notice*, CC Docket No. 96-45, DA001705 (rel. Aug. 1, 2000).

³ Several appointees were not present or involved during the final months of meetings and conference calls of the Task Force. Because they did not take part in the final deliberations and because the Task Force had agreed early on that they must be present to vote, several appointees' names do not appear on the Recommendation signature page.

RURAL TASK FORCE RECOMMENDATION

The following summarizes the major conclusions of the Task Force:

- The Task Force's Recommendation should be implemented immediately and remain in place for a five-year period. Plans should be made to reevaluate appropriate universal service funding approaches for areas served by Rural Carriers prior to the end of this five-year period.
- The Task Force recommends that the Synthesis Model not be used for determining the forward-looking costs of Rural Carriers.
- The Task Force recommends the Modified Embedded Cost Mechanism of federal universal service support for Rural Carriers be adopted for sizing the Rural Carrier federal universal service fund.
- The Task Force recommends a flexible system for disaggregating support to establish the portable per line support available to all eligible telecommunications carriers with timely distributions.
- The Task Force recommends that states be delegated responsibility for oversight of the use of universal service support in a manner similar to that used for the non-rural LECs.
- The Task Force recommends that the Joint Board review the definition of the services that are supported by federal universal service support mechanisms, and that a "no barriers to advanced services" policy be adopted.
- The Task Force recommends the Joint Board and Federal Communications Commission (FCC) enact modifications to the caps and limitations on universal service funding which currently exist:
 - The High Cost Loop Fund should be re-based by increasing it \$118.5 million, grown by an annual factor, and include a "safety net;"
 - The corporate operations expense limitation should be adjusted for growth; and
 - A "safety valve mechanism" should be added to the limitation on support for acquired or transferred exchanges.
- The Task Force recommends a set of principles to be used in addressing implicit support in interstate access charges, and recommends creation of High Cost Fund III to take the place of any implicit support removed from interstate access.

II. CONTEXT AND EVIDENTIARY FOUNDATION

A. Overview

Shortly after its formal organization in July of 1998, the Task Force developed a mission statement, working objectives and guiding principles for its ultimate recommendation to the Joint Board. Specifically, the Task Force clarified its mission “. . . to review and evaluate alternative universal support mechanisms which affect consumers in rural and insular areas served by rural telephone companies and to make recommendations to the CC 96-45 Joint Board on appropriate universal service support mechanisms, methods and policies to faithfully implement the universal service provisions of the Telecommunications Act of 1996 for these rural and insular areas.”⁴

Three specific objectives were established to guide the work of the Task Force:

1. The Task Force should review a broad range of options, including the continuation or adaptation of the current system of support, a system of support based on forward-looking cost models, and any other mechanism consistent with the universal service support and pro-competitive provisions of the 1996 Act;
2. The Task Force should identify issues that are unique to carriers that serve rural or insular areas and recommend means to address those unique characteristics; and
3. Where necessary, the Task Force should recommend transitional mechanisms, hold harmless provisions, or modifications to minimize adverse impacts to rural or insular consumers and to facilitate investment in modern telecommunications infrastructure by service providers serving rural and insular areas.

These three objectives formed the work plan underlying the Recommendation described in this final report. In preparing this Recommendation, the Task Force has also relied on three broad principles established during its early organizational phase. First, the Recommendation must conform to the universal service principles established by Congress in Section 254(b) of the 1996

⁴ See “Mission Statement, Objectives and Principles for Developing a Recommendation”, adopted by the Task Force December 12, 1998, available at www.wutc.wa.gov/rff.

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Act.⁵ Second, any support mechanism recommended by the Task Force must be economically and administratively workable. Third, the Recommendation must be consistent with extending benefits of competitive telecommunications markets to rural and insular areas and with the principle of competitive neutrality. We believe that this final Recommendation to the Joint Board is consistent with these three guiding principles.

In its deliberations, the Task Force has utilized an open, collegial process, involving not only its members, but also a diverse group of interested stakeholders. In general, the Task Force has developed its Recommendation through consensus rather than hard votes around alternative positions. This approach is pragmatic, and it is intended to deliver to the Joint Board a package of recommendations with the potential of being implemented promptly and without legal challenge from affected parties. We observe that while every party has a right to challenge regulatory decisions through appropriate legal avenues, such challenges ultimately result in uncertainty for all parties. Uncertainty over available universal service support ultimately discourages investment in high cost rural areas by both ILECs and CLECs.⁶ Our Recommendation builds on the strengths of the Task Force members by developing an up-front consensus among a diverse group of stakeholders on an appropriate universal service mechanism for Rural Carriers.

The Recommendation has its foundation in a deliberate written evidentiary record. That record has been assembled in the form of six white papers available on the Rural Task Force web page.⁷ Within this final report to the Joint Board, the Task Force will cite and develop appropriate linkages to the written evidentiary record contained in these white papers, as well as to the foundation laid by the 1996 Act and FCC policy documents.

⁵ (1) QUALITY AND RATES.--Quality services should be available at just, reasonable, and affordable rates. (2) ACCESS TO ADVANCED SERVICES.--Access to advanced telecommunications and information services should be provided in all regions of the Nation. (3) ACCESS IN RURAL AND HIGH COST AREAS.--Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. (4) EQUITABLE AND NONDISCRIMINATORY CONTRIBUTIONS.--All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service. (5) SPECIFIC AND PREDICTABLE SUPPORT MECHANISMS.--There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service. (6) ACCESS TO ADVANCED TELECOMMUNICATIONS SERVICES FOR SCHOOLS, HEALTH CARE, AND LIBRARIES.--Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h). (7) ADDITIONAL PRINCIPLES.--Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.

⁶ "ILEC" means incumbent local exchange company; "CLEC" means competitive local exchange company. As used in the Recommendation, we intend to include all competitive service providers, including wireless carriers, in the term CLEC.

⁷ See www.wutc.wa.gov/rtf. For any references to Task Force white papers hereafter, please refer to the Task Force web pages for copies.

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B. Legal and Policy Foundation for the Task Force Recommendation

Early in its process, the Task Force reached consensus on the legal and policy foundation underlying this Recommendation on the appropriate universal service mechanism and policies for universal service in areas served by Rural Carriers. That consensus was formalized in the Task Force's first White Paper entitled, "Rural Task Force Mission and Purpose," published December 1998.

The Task Force recognizes that many of the nation's rural communities are currently served by ILECs and CLECs that provide service to high-cost areas served by non-Rural Carriers. The universal service support needs of these communities were addressed by the FCC in November 1999.⁸

This Recommendation specifically addresses the universal service support needs of the remaining rural, insular and high cost communities currently served by Rural Carriers and CLECs serving those same areas. Both the 1996 Act and statements by the FCC make clear that the universal service mechanism, as well as policies applied in implementing that mechanism for Rural Carriers, may be appropriately different than those adopted for non-Rural Carriers.⁹ The Task Force's White Paper 1 provides a complete record detailing relevant citations from the 1996 Act and FCC orders. For purposes of establishing a foundation for this Recommendation, we highlight only a few of the key legal and policy citations in this document.

An essential foundation to our Recommendation is the statutory framework and underlying national policy objectives enacted by Congress in the 1996 Act. The Recommendation considers all relevant provisions of the law including those consistent with extending the benefits of a competitive telecommunications market to rural or insular areas along with the principle of competitive neutrality. However, the heart of the Congressional directive is contained in the universal service principles of Section 254.

The 1996 Act's universal service policies articulated in Section 254(b) generally ensure that all individuals and businesses will have the opportunity to share not only the benefits of a nationwide telephone network, but also the benefits generated by the ongoing global transformation of the availability and uses of information.¹⁰ The 1996 Act broadens the traditional concept of universally available quality telephone service at just, reasonable and affordable rates to include a commitment to make available access to advanced telecommunications and information services "...in all regions of the Nation."¹¹ The law requires the FCC and the Joint Board to define the services that will receive federal support. The 1996 Act also institutes a program for ensuring nationwide progress as telecommunications and information development unfolds, by requiring regular reexamination of an evolving definition of universal service pursuant to Section 254(c).

⁸ In re: Federal-State Universal Service Joint Board, CC Docket No. 96-45 *Ninth Report and Order and Eighteenth Order on Reconsideration* (rel. Nov. 2, 1999). This order will be referred to hereinafter as the "Non-Rural Order."

⁹ *Id.* Non-Rural Order at paragraph 11.

¹⁰ The Task Force notes the parallel language of Section 706 of the 1996 Act, 47 U.S.C. 157.

¹¹ The 1996 Act also provides for discounts for schools, libraries and rural health care providers and support for low-income consumers.

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Section 254(d) of the 1996 Act requires all carriers that provide interstate service to contribute on an equitable and non-discriminatory basis to support the costs of ensuring nationwide service and network development at affordable and reasonably comparable rates. As a result, the federal mechanism was intended to spread the burden of maintaining and advancing a nationwide public switched network across all carriers and their customers.¹² Section 254(f) provides that a state may adopt regulations not inconsistent with the FCC's rules to preserve and advance universal service. A state may adopt regulations providing additional definitions and standards to preserve and advance universal service within that state only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

The 1996 Act expressly sets a standard of adequacy for the federal universal support program in that the support "should be explicit and sufficient to achieve the purposes of this section." Sufficiency of support must be gauged against the standards embodied in the universal service principles set forth in Section 254(b).

The 1996 Act also sets standards to prevent waste, windfalls and excessive expense for contributing carriers and their customers. Support may be provided only to a carrier designated as eligible pursuant to Section 214(e). In addition, Section 254(e) provides that any carrier that receives federal support "shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." Finally, services that are not competitive should "bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."¹³

The principles in Section 254(b) spell out the results Congress expects to achieve with the universal service mechanisms. Congress also allowed the Joint Board and the FCC to adopt additional principles they found are "necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act."¹⁴ In its May 8, 1997, Universal Service Order the FCC added the principle of competitive neutrality for support mechanisms, which the Task Force took into account in framing its recommendations.¹⁵

¹² Section 254 (b) (4) of the 1996 Act establishes the principal that "all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." Section 254 (d) establishes the obligation that "every telecommunications carrier that provides interstate telecommunications services shall contribute on an equitable and nondiscriminatory basis, to the specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service." That section also gives the Commission the authority to exempt *de minimis* contributions and require contributions from "any other provider of interstate telecommunications." The law does not distinguish between interstate and intrastate revenues but requires all carriers to contribute. In addition, the act defines the term "telecommunications" broadly. The Task Force recommends in order to help ensure the long term stability of universal service funding that universal service support contributions should be assessed on the broadest possible base.

¹³ Section 254(k) of the 1996 Act.

¹⁴ Section 254(b)(7) of the 1996 Act.

¹⁵ The FCC recognized, however, that given the complexities and diversity of the telecommunications marketplace, it would be extremely difficult to achieve strict competitive neutrality. See In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Report and Order* (rel. May 8, 1997) at Paragraph 48.

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While the universal service principles of the 1996 Act apply equally to Rural Carriers and non-Rural Carriers, Congress explicitly recognized in the 1996 Act that policies pertaining to competitive entry and universal service reform for the "rural telephone companies" may be appropriately different than for other companies. The 1996 Act gives state commissions a degree of latitude to make determinations about which carriers are eligible to receive support based on local circumstances affecting the pace and impact of competitive entry and universal service reform.

Section 214(e)(2) of the 1996 Act gives state commissions a role in deciding whether to designate multiple providers as eligible telecommunications carriers (ETCs) able to receive support for providing federally-defined universal service in an area served by a Rural Carrier.¹⁶ Before designating an additional ETC for an area served by a Rural Carrier, the state commission is required to find that the designation is in the public interest. Section 214(e)(5) defines the term "service area" for the purpose of determining universal service obligations. For areas served by Rural Carriers, this section adds the requirement that an ETC must serve the ILEC's entire study area¹⁷ unless and until the FCC and the states, after taking into account recommendations of the Joint Board, establish a different definition of service area for each company.

Section 251(f)(1) of the 1996 Act exempts Rural Carriers from certain duties to interconnect and provide unbundled network access that apply to other non-rural ILECs. State commissions must evaluate any *bona fide* request to a Rural Carrier for interconnection or network elements to ensure that the request is not unduly economically burdensome, is technically feasible, and is consistent with Section 254.

For an area served by a Rural Carrier, Section 253(f) permits a state commission to require a CLEC to be an ETC as a condition of providing telephone exchange service or exchange access in a Rural Carrier's service area.¹⁸ In effect, the law requires the state commission to examine public interest questions concerning a Rural Carrier's study area. By including this provision Congress recognized that unrestricted entry may not be beneficial to consumers in some rural ILEC areas. At the same time, Congress did not intend to deny rural consumers the benefits of competition when the state determines that competition is in the public interest. Notably, Congress did not place similar restrictions on areas served by non-Rural Carriers. This demonstrates a decision by Congress to allow policies pertaining to competitive entry and universal service reform for Rural Carriers to be appropriately different than for non-Rural Carriers.

The Task Force notes that recent Joint Board recommendations and FCC orders also recognize appropriate universal service mechanisms and policies for Rural Carriers may differ from

¹⁶ The FCC has not adopted rate or service obligations for competitive ETCs (CETCs).

¹⁷ A "study area" is generally the entire territory within a single state served by a telephone company.

¹⁸ Section 253 of the 1996 Act. [47 U.S.C. 253] REMOVAL OF BARRIERS TO ENTRY (f) RURAL MARKETS.--It shall not be a violation of this section for a State to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the requirements in Section 214(e)(1) for designation as an eligible telecommunications carrier for that area before being permitted to provide such service. This subsection shall not apply--(1) to a service area served by a rural telephone company that has obtained an exemption, suspension, or modification of Section 251(c)(4) that effectively prevents a competitor from meeting the requirements of Section 214(e)(1); and (2) to a provider of commercial mobile services.

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those adopted for non-Rural Carriers. For example, the Joint Board on Universal Service officially moderated its commitment to using a universal service support mechanism based on forward-looking economic cost (FLEC) for the Rural Carriers, even as it moved toward implementing such a support system for non-Rural Carriers. The Joint Board's Second Recommended Decision cautions that "in recommending this framework for determining non-rural carriers' high cost support based on forward-looking cost, we do not intend for the FCC to create any precedent for any potential revisions to support mechanisms for rural carriers."¹⁹ This important aspect of the Joint Board's Second Recommended Decision was adopted and expanded upon by the FCC in its Non-Rural Order adopting the FLEC proxy cost model for non-Rural Carriers.²⁰

Rural and insular differences have been a principal reason for delay of access reform for rate-of-return regulated ILECs. These differences convinced the FCC that it should not implement reform for the primarily small and rural rate-of-return regulated ILECs in the same manner, or at the same time, that it reformed access charges for the larger price cap-regulated carriers. On May 26, 1998, the FCC opened a separate access reform proceeding for rate-of-return-regulated ILECs. In the Notice of Proposed Rulemaking (NPRM), the FCC acknowledged that rate-of-return-regulated ILECs face significantly higher costs and recover a much larger percentage of their total revenues from access charges than do price cap-regulated ILECs.²¹ The FCC also acknowledged the substantial differences among rate-of-return-regulated carriers, stating that "[t]hey are not, however, a homogenous group, and their operating conditions vary significantly."²² These different circumstances, the FCC recognized, "may require different approaches to reform, including a different transition to more economically efficient, cost-based interstate access charges."²³

C. Empirical Justification for a Distinct Rural Carrier Universal Service Mechanism

Congress, the FCC and the Joint Board have each concluded that universal service mechanisms and policies applying such mechanisms must be flexible in recognition that market and operational factors associated with Rural Carriers may be substantially different from those associated with non-Rural Carriers. For the most part, however, the precise scope and magnitude of those differences had not been documented. Recognizing this gap in the evidentiary record, the Task Force undertook a detailed study of the "rural differences." Conclusions from that study are summarized in White Paper 2, "The Rural Difference," released by the Task Force in January

¹⁹ In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Second Recommended Decision* (rel. Nov. 25, 1998) at Paragraph 30.

²⁰ "The support mechanism for rural carriers will remain unchanged at least until January 1, 2001, and reform will be undertaken only after the Commission, the Joint Board, and a Rural Task Force appointed by the Joint Board have selected an appropriate methodology for rural support." Non-Rural Order at Paragraph 11.

²¹ Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, *Notice of Proposed Rulemaking*, FCC 98-101 (rel. June 4, 1998), Paragraphs 16 and 35 (Rate-of-Return Access NPRM).

²² *Id.*, Paragraph 14.

²³ *Id.*, Paragraph 4.

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2000.²⁴ White Paper 2 analyzes publicly available national data assembled for the first time, to systematically compare and contrast Rural Carriers and non-Rural Carriers. Equally important, the analysis conducted by the Task Force documents a substantial diversity among Rural Carriers themselves. An understanding of the differences between Rural Carriers and non-Rural Carriers and the diversity among Rural Carriers is key to designing appropriate mechanisms and policies which will allow the fulfillment of the 1996 Act's universal service principles.

The following are major Rural Carrier differences identified by the Task Force and described in White Paper 2:

Rural Carriers serve more sparsely populated areas

- Both Rural Carriers and non-Rural Carriers serve rural communities. However, Rural Carriers' operations tend to be focused in the more geographically remote areas of the nation with widely dispersed populations.
- Nationwide, Rural Carriers serve about eight percent of the nation's access lines, 38 percent of the nation's land area, and 93 percent of the study areas.
- The average population density is only 13 persons per square mile for areas served by Rural Carriers compared with 105 persons per square mile in areas served by non-Rural Carriers.
- Evaluating proxy cost model output for a representative sample of ten states, Rural Carriers serve 70 percent of the modeled serving areas with fewer than five lines per carrier serving area, but only ten percent of the modeled serving areas with over 100 lines per carrier serving area.

There is significant variation in study area sizes and customer bases among Rural Carriers

- The vast majority of access lines served by Rural Carriers are clustered in the largest study areas in terms of line size.
- Rural Carriers serving the three smallest study area groupings (2,500 lines or less) encompass 48 percent of all study areas in terms of line size, but only five percent of all access lines served by Rural Carriers. On the other hand, Rural Carriers serving the three largest study area groupings (20,000 lines or more) contain only 10.5 percent of all study areas, but 67 percent of all Rural Carrier access lines.
- The average population density of areas served by Rural Carriers varies dramatically. Rural Carriers in Alaska and Wyoming serve populations of 0.58 and 1.25 persons per square mile respectively, while Rural Carriers in some states serve populations of over 100 persons per square mile.

²⁴ See www.wutc.wa.gov/rtf.

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Isolation of areas served by Rural Carriers results in numerous operational challenges

- Rural Carriers have relatively high loop costs because of the lack of economies of scale and density.
- Rural Carriers experience difficulty and high cost in moving personnel, equipment and supplies to remote and insular communities.
- Geographic surface conditions - such as coral, volcanic rock and permafrost - require expensive specialized outside plant construction practices.
- More resources, including duplicate facilities and backup equipment are required to protect network reliability.

Compared to non-Rural Carriers, the customer base of Rural Carriers generally includes fewer high-volume users, depriving Rural Carriers of economies of scale

- On average, multi-line business customers represent about 13 percent of total business lines served by Rural Carriers compared to over 21 percent of the lines served by non-Rural Carriers.
- Non-Rural Carrier study areas typically have higher business customer density than Rural Carrier study areas.
- On average, special access services purchased by large users only represent about three percent of total interstate revenues for Rural Carriers compared to nearly 18 percent for non-Rural Carriers.
- There is substantial diversity among Rural Carriers in providing special access service to customers. Interstate special access revenues compared to total interstate revenues for Rural Carriers range from zero to 36 percent.

Compared to customers of non-Rural Carriers, customers of Rural Carriers tend to have a relatively small local calling scope and make proportionately more toll calls

- On average, local minutes comprise 85 percent of total intrastate minutes for non-Rural Carriers, but only about 69 percent of total intrastate minutes for Rural Carriers.
- Rural Carriers have a higher average proportion of interstate toll minutes to total minutes (21 percent) than non-Rural Carriers (16 percent).
- Seventy to 80 percent of customers of smaller Rural Carriers can reach less than 5,000 other customers with a local call. Only 10 percent of smaller Rural Carriers have local calling capability to reach as many as 25,000 other subscribers.

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Rural Carriers frequently have substantially fewer lines per switch than do non-Rural Carriers, providing fewer customers over which to spread high fixed network costs

- On average, Rural Carriers have only 1,254 customers per switch compared to over 7,000 customers per switch for non-Rural Carriers.
- For Rural Carriers, the number of lines per switch decreases dramatically as the line size of the study area served decreases. Rural Carrier study areas with more than 100,000 lines average nearly 3,000 lines per switch, compared to an average of only 223 lines per switch for study areas with less than 500 lines.

Total investment in plant per loop is substantially higher for Rural Carriers than for non-Rural Carriers

- On average, total plant investment per loop is over \$5,000 for Rural Carriers compared to less than \$3,000 for non-Rural Carriers.
- Average total plant investment per line for Rural Carriers increases as the line size of the study area decreases. Average total plant investment per line ranges from \$3,000 for Rural Carriers with the largest study areas to over \$10,000 for Rural Carriers with the smallest study areas.
- The range of values for total plant investment per loop for Rural Carriers (\$1,400 to \$40,500) is far greater than the range for non-Rural Carriers (\$1,570 to \$4,350).

Plant specific and operations expenses for Rural Carriers tend to be substantially higher than for non-Rural Carriers

- On average, plant specific expenses per loop are \$180 for Rural Carriers compared to \$97 per loop for non-Rural Carriers.
- Average Rural Carrier plant specific expenses increase consistently as the number of lines served decreases, from approximately \$110 per loop for carriers with more than 20,000 lines to \$445 per loop for carriers with study areas having less than 500 lines.
- The range of total plant specific expenses per loop for Rural Carriers (\$4 to \$1,585) is substantially greater than for non-Rural Carriers (\$38 to \$163).
- Depreciation expenses and corporate operations expenses per loop tend to follow similar trends as plant specific expenses, that is, they increase as the number of lines served decreases.

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Customers served by Rural Carriers have different demographic characteristics from customers in areas served by non-Rural Carriers

- 1990 U.S. Census data indicates the average annual household income for customers in Rural Carrier Service areas was \$31,211, twenty percent lower than that of non-Rural Carrier customers (\$38,983).
- Native Americans are disproportionately represented among those without phone service. Rural Carriers serve a higher percentage of Native American customers than non-Rural Carriers.²⁵
- The Kindergarten– 12th Grade school is the point of Internet access for 30 percent of persons in rural areas, compared to only 21.8 percent for the nation as a whole.²⁶

In passing the 1996 Act, Congress was clear that we are one nation, and that national universal service policy must ensure that the benefits of telecommunications industry reform accrue to all Americans, including those in remote, rural and insular regions. The evidentiary record assembled by the Task Force clearly supports a conclusion that a “one-size-fits-all” national universal service policy is unlikely to be successful in fulfilling the national universal service principles contained in the 1996 Act. To be successful, the policies and mechanisms ultimately adopted must be flexible enough to accommodate the wide range of market and operational circumstances faced by telecommunications carriers serving rural populations. This observation, grounded in empirical evidence, is fundamental to the choices and recommendations advanced by the Task Force.

D. Policy Context Facilitating Both ILEC and CLEC Investment in Rural Communities

A high quality telecommunications infrastructure is necessary in order to provide for the economic, educational, health care and other opportunities essential to the future vitality of our rural communities. The Task Force reached agreement that a primary purpose of universal service support is to promote investment by both ILECs and CLECs in rural America’s telecommunications infrastructure. This investment is necessary to ensure universal access to telecommunications services which are comparable to those available in urban areas, and to provide a platform for delivery of advanced services.

A universal service system which delivers sufficient support should also provide proper incentives for investment in rural America. In order to provide these incentives, the universal support mechanism should be transparent, stable, predictable, and competitively neutral as well as sufficient. To this end, the Recommendation is based on a consensus of diverse interests. This

²⁵ For more information on Rural Carrier service to Native Americans, see National Telephone Cooperative Association (NTCA) paper, *Dial Tone is Not Enough: Serving Tribal Lands*; NTCA, November 1999, and *NTCA Members Serving Tribal Areas Survey Report*, NTCA, December 10, 1999. See www.ntca.org.

²⁶ National Telecommunications and Information Administration, *Falling Through the Net: Defining the Digital Divide* (July 1999), page 36, Chart II-15.

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should minimize controversy and legal challenges which create delay and uncertainty, and discourage investment. The Recommendation also attempts to provide sufficient support on an economically viable, administratively workable, and accountable basis. This should ensure that support is available to all carriers who accept the responsibilities of becoming ETCs, and that support is targeted to rural areas in a cost-effective manner.

The universal service mechanism recommended by the Task Force is a package of initiatives designed to provide both ILECs and CLECs with predictable and stable funding to motivate investment over the near-term future. The Task Force recognizes that the telecommunications industry is dynamic and changing rapidly. We believe it is unrealistic to expect any universal service mechanism to provide a stable, predictable and workable funding source for a period longer than five years. Consequently, we recommend that the Recommendation be implemented immediately and remain in place for a five year period. Plans should be made to evaluate appropriate universal service funding approaches for areas served by Rural Carriers prior to the end of this five year period.

III. METHODS AND POLICIES TO ESTABLISH PREDICTABLE AND SUFFICIENT SUPPORT FOR RURAL CARRIERS

Over the past two years the Task Force has undertaken a deliberative process to consider alternative methods and specific policies to establish predictable and sufficient financial support for Rural Carriers operating within high cost areas. In evaluating these alternative methods and policies, the Task Force gave careful consideration to all aspects of the 1996 Act, including the competitive provisions and universal service principles outlined in Section 254(b). Further, the Task Force gave significant weight to the administrative and economic viability of each alternative. As has been noted, a detailed record of the Task Force's proceedings are documented by the Task Force in a series of white papers and in meeting minutes available on the Task Force website.²⁷ Our purpose here is to highlight only briefly the key considerations and describe the specific recommendations agreed to by Task Force members.

A. Alternative Methods for Sizing the Fund –Overview of Options Considered

In its Mission Statement the Task Force made a commitment to explore alternative mechanisms for determining universal service support for Rural Carriers.²⁸ Throughout the course of its work, the Task Force considered a number of options for determining appropriate levels of universal service support for rural companies. In evaluating the different methods, the Task Force was guided by criteria developed early in the Task Force deliberations. These criteria are not simple restatements of the universal service principles.²⁹ They combine the universal service

²⁷ See www.wutc.wa.gov/rtf.

²⁸ See *Mission Statement, Objectives and Principles for Developing a Recommendation*, adopted by the Task Force December 12, 1998, available at www.wutc.wa.gov/rtf.

²⁹ *Id.*

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principles with the tenets of technological and competitive neutrality, network evolvability, and economic and administrative viability.³⁰

The Task Force criteria for an appropriate support mechanism for Rural Carriers may be summarized as follows:

1. **Sufficiency:** Does the mechanism ensure comparability of service and rates between urban or suburban customers and rural or insular customers?
2. **Affordability:** Does the mechanism enable providers to offer the supported services in an affordable manner?
3. **Competition:** Does the mechanism encourage and facilitate competition by precisely targeting support to high cost customers?
4. **Flexibility:** Is the mechanism able to evolve as new technologies are introduced, as competition develops, and as the definition of universal services changes over time?
5. **Protection and Advancement:** Does the mechanism prevent degradation of the existing infrastructure and the current level of service? Does the mechanism produce an investment incentive to upgrade facilities used to provide universal service?
6. **Portability:** Can the mechanism provide to all ETCs an appropriate amount of support in a competitively neutral manner?
7. **Predictability:** Does the mechanism enable a competitor or incumbent carrier to determine in advance the amount of support it will receive on behalf of a customer?
8. **Practicality:** Is the mechanism economically and administratively viable?

In reviewing the different alternative support mechanisms set forth below, the Task Force applied these criteria to each alternative. In developing its record, the Task Force considered several alternative methods to size the Rural Carrier fund including:

- a) The Current Rural Support Mechanism (also referred to as the “Embedded Cost” Mechanism);
- b) A Modified Embedded Cost Mechanism explicitly considering policy applications to address sufficiency and competitive concerns;
- c) The FCC’s mechanism for non-Rural Carriers using a forward-looking cost model;

³⁰ See *Criteria to Determine if the Final Universal Service Support Mechanism for RTC's is Reasonable*, available at www.wutc.wa.gov/rtf.

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- d) Competitive bidding approaches;
- e) Rate Buy-down Mechanisms, which allow rates to float to market level with an adjustment assuring customers pay no more than a targeted affordable level; and
- f) A Melded Approach representing an attempt to blend the strengths of both the embedded cost mechanism and the Synthesis Model.

The strengths and weaknesses of each of these alternatives were identified and compared in White Paper 3, "Alternative Mechanisms for Sizing A Universal Service Fund for Rural Telephone Companies," published in August, 2000. Of the approaches evaluated, the Modified Embedded Cost Mechanism, with policy modifications to accommodate the sufficiency and competitive mandates of the 1996 Act, and the FCC non-rural method were considered to be the primary candidates for recommendation as the appropriate mechanism to size the universal service fund for Rural Carriers.

B. Evaluation of the Synthesis Model Applied to Rural Carriers

The Public Notice establishing the Rural Task Force directed the Task Force to give special consideration to the proxy cost models used for sizing and targeting universal service support to non-Rural Carriers.³¹ The FCC, in fact, ultimately adopted a proxy cost model for use in sizing and targeting the non-rural fund in its Non-Rural Order.³² The Task Force gave careful consideration to the model adopted by the FCC for non-Rural Carriers, and examined both the potential value and risks associated with applying the same model for determining forward-looking support for Rural Carriers and competitors serving customers in those areas. In conducting this analysis, the Task Force developed and adopted criteria in November 1999 for the evaluation of the proxy model tool for use with Rural Carriers. The criteria are detailed in White Paper 4 "A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies."

A detailed study was made of 23 sample companies. Also, a comparison of model results to actual company data for 195 additional companies was made. Attempts were made to study a diverse group of companies in terms of size, geography and regions of the nation. Application of the FCC Synthesis Model to the rural test companies produced the following results:

- The model lines differed significantly from actual lines served. While the model generally tended to underestimate lines, in about one-third of the wire centers it overestimated lines.

³¹ "Federal-State Joint Board on Universal Service Announces the Creation of Rural Task Force; Solicits Nominations for Membership on the Rural Task Force." *Public Notice* FCC 97J-1, (rel. Sept. 17, 1997).

³² See Non-Rural Order. These support calculations were revised on January 20, 2000, and April 7, 2000. See, "Common Carrier Bureau Announces Procedures for Releasing High-Cost Support Amounts for Non-Rural Carriers and Revised Model Results," FCC *Public Notice*, CC Docket No. 96-45, 97-160, DA 00-110 (Jan. 20, 2000) and In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Twentieth Order on Reconsideration*, FCC 00-126 (April 7, 2000). Under these revised figures total annual funding for non-rural companies is estimated to be \$220 million (exclusive of "hold harmless" support).

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- Comparisons of the number of route-miles of plant summarized in the model with actual data produced significant variations. Again, differences occurred on both the high and low ends with a general tendency for the model results to overestimate the actual data. In 12 percent of the wire centers studied, the model overestimated route miles by more than 200 percent.
- Model results for the type of plant varied widely from actual plant constructed. The model generally tended to overestimate the percentage of aerial and underground plant, and underestimated the percentage of buried plant. This was likely due to the diverse character of the rural geography, and the use of a single set of inputs by density zone that was based on the experience of non-Rural Carriers.
- In calculating the applicable density zones, the model significantly underestimated wire center area. In 95 percent of wire centers the land area was understated, and in over one third of these the understatement exceeded 90 percent.
- The Synthesis Model significantly underestimated central office equipment (COE) Switching investment. This was likely due to the lack of economies of scale of the Rural Carriers, and the general tendency of the model to underestimate lines served.
- The Synthesis Model results for various elements of general support investment varied widely from actual data and from rational forward-looking assumptions, with almost as many cases of overestimation as underestimation.
- Network Operations and Customer Operations expenses were significantly underestimated. This was likely related to the lack of economies of scale of Rural Carriers.

The analysis also indicated that the model does not currently contain customer location and other data to produce results for rural wire centers in Alaska and the insular areas. The reasons for this are detailed in White Paper 4.

The aggregate results of this study suggest that, when viewed on an individual rural wire center or individual Rural Carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. As a result, it is the opinion of the Task Force that the current model is not an appropriate tool for determining the forward-looking cost of Rural Carriers.

In making this recommendation, the Task Force recognizes that policy makers, after the development and rigorous analysis of the Synthesis Model, have determined that it should be applied in developing universal service support for non-Rural Carriers. While the Task Force arrived at a different conclusion in regard to use of the model for Rural Carriers, we do not intend to imply in any way that revisions are needed to support mechanisms for non-Rural Carriers. Our analysis and recommendations are focused solely on Rural Carriers.

C. Tools versus Application

In considering both the potential value and risks associated with applying the FCC's Synthesis Model to estimate and target sufficient universal service support to Rural Carriers and competitors serving the same areas, it was obvious that the policies underlying the application of the proxy cost model tool were equally important, if not more important than the tool itself. An initial step in the Task Force's analysis was to directly apply both the Synthesis Model and the FCC's method for determining high-cost support for non-Rural Carriers. The results of that analysis are documented in White Paper 4.

We note here that applying the FCC's Synthesis Cost Model directly to the task of sizing the national Rural Carrier high cost fund and using the same policy mandates adopted for non-Rural Carriers would reduce available support to Rural Carriers from the current \$1.553 billion to \$451 million, a reduction of over one billion dollars. A primary reason for that reduction was the FCC's decision to rely on a nationwide benchmark and statewide cost-averaging to determine a "sufficient" level of federal funding for non-Rural Carriers. Because Rural Carriers represent only a fraction of the overall industry, their addition in determining the national average cost benchmark changes the average by only a small amount,³³ even though as a group the average total cost of service for Rural Carriers is more than twice that of non-Rural Carriers.³⁴ For the same reason, averaging the cost of Rural Carriers with the costs of all other carriers within a state would eliminate funding for many Rural Carriers. Thirty-seven states, territories, and protectorates which receive federal universal service support for Rural Carriers today would receive zero support if statewide cost-averaging and a national benchmark were used in sizing the universal service fund available to Rural Carriers.³⁵

The Task Force recognizes that policymakers would not likely adopt a statewide cost-averaging and a national benchmark for application to the Rural Carrier mechanism with this knowledge available to them. We further recognize that alternative benchmarks are easily considered. However, the exercise of applying the non-Rural Carrier policies directly in considering use of the Synthesis Model for sizing the Rural Carrier fund was helpful to Task Force members, highlighting the importance of specific policy choices in designing an appropriate support mechanism tool and policy.

This line of inquiry and the record assembled to support the inquiry is instrumental to the Task Force's recommendation of the method to size the fund necessary to provide sufficient support to Rural Carriers and competitors providing service in those areas. Weaknesses associated with both the Synthesis Cost Model and embedded cost approaches can potentially be mitigated by appropriate policy choices. Consequently, the choice of method to size and target the fund may

³³ The estimated nationwide average cost per line increases from \$23.52 per line for non-Rural Carriers to \$26.09 per line for non-Rural Carriers and Rural Carriers combined.

³⁴ The estimated average cost per line for Rural Carriers is \$59.36 per line compared to an estimated \$23.52 per line for non-Rural Carriers. It should be noted that based on subsequent input changes for the Synthesis Model, the current estimated nationwide average cost per line for non-Rural Carriers has changed to \$23.35 per line.

³⁵ See Appendix D of White Paper 4.

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appropriately rest at least in part on practical considerations; such as administrative simplicity and ease of minimizing unintended consequences.³⁶

D. Recommended Method for Sizing the Fund

For the reasons detailed in White Paper 4, we conclude that the non-rural method and Synthesis Model developed for the non-Rural Carriers are not the appropriate tool and application for Rural Carriers and will not produce a sufficient universal service mechanism for Rural Carriers that is in the public interest and consistent with the principles of the 1996 Act. The Task Force Recommendation relies on the Modified Embedded Cost Mechanism for Rural Carriers as a baseline to size the fund for Rural Carriers. This method is based on embedded costs of each ILEC's study area. In other words, support is based on the investments and expenses of each study area.

There are three forms of support currently flowing to Rural Carriers:

1. The High Cost Loop³⁷ (HCL) fund helps offset the cost of loop facilities used to provide local service. When a study area's average loop cost exceeds 115 percent of the national average loop cost, that study area receives a portion of its costs above 115 percent from the fund. The amount of support increases in specified steps as the percentage of cost that exceed the national average rises.
2. Long-Term Support³⁸ (LTS) helps offset the cost of interstate access for Rural Carriers remaining in the National Exchange Carrier Pool (NECA) pool.
3. Local Switching Support³⁹ (LSS) provides support for the high per-line local switch equipment costs incurred by carriers with less than 50,000 loops.

These three funds currently provide approximately \$1.553 billion in annual support to the over 1,300 Rural Carrier study areas in the United States and its territories. Each form of support is determined by averaging costs over the company's entire study area. (LTS is averaged over all companies participating in the NECA common line pool.) Per line support is determined by dividing total support by the total number of lines within a study area.

The total amount of the HCL available for Rural Carriers is currently capped. Under the cap, overall high cost support grows at the same rate as the growth in the number of access lines, including the lines of non-Rural Carriers. It is estimated that without the cap, the High Cost Fund

³⁶ The Task Force did not compute the impact on Rural Carriers of using the current Rural Carrier benchmarks and policies with the Synthesis Model. This was not done for several reasons in addition to the fact that the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. These reasons included the perceived administrative complexity of adapting the Part 36 Rules for calculating the High Cost Loop fund and Local Switching Support to the Synthesis Model, and the anticipated significant increase in high cost support that would result from such an analysis, which would be applied on a study area basis.

³⁷ See 47 C.F.R. Section 36.631.

³⁸ See 47 C.F.R. Section 54.303.

³⁹ See 47 C.F.R. Section 54.301.