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

In the Matter of	)	
	)	
Federal-State Joint Board on	)	
Universal Service	)	CC Docket No. 96-45
	)	
Rural Task Force Recommendation to	)	
The Federal-State Joint Board	)	
	)	
Multi-Association Group (MAG) Plan for	)	
Regulation of Interstate Services of	)	CC Docket No. 00-256
Non-Price Cap Incumbent Local	)	
Exchange Carriers and Interexchange	)	
Carriers	)	
	)	
Access Charge Reform for Incumbent	)	
Local Exchange Carriers Subject to	)	CC Docket No. 98-77
Rate-of-Return Regulation	)	
	)	
Prescribing the Authorized Rate of	)	CC Docket No. 98-166
Return For Interstate Services of Local	)	
Exchange Carriers	)	
	)	

COMMENTS OF THE AD HOC
TELECOMMUNICATIONS USERS COMMITTEE

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February 26, 2001

SUMMARY

The Ad Hoc Telecommunications User Committee advocates a universal service support mechanism for rural and non-rural carriers alike that is explicit, targeted, competitively neutral, and properly sized to support universal service and nothing more. The emergence of competition in rural and high cost areas, as encouraged by the Telecommunications Act of 1996, requires a universal service support mechanism that does not handicap the competitive race by reimbursing incumbent rural carriers for their inefficient investments.

Neither the Rural Task Force ("RTF") nor the MAG have made a persuasive showing that the Commission should depart from its earlier decisions in the universal service arena. Moreover, the recommendations of the RTF and the MAG would distinguish rural carriers from non-rural carriers and reward the incumbent rural carriers for their inefficient past investment decisions while inflating the universal service fund to unprecedented (and unconstrained) levels.

The Commission should reject the proposals of the RTF and the MAG to (1) use an embedded cost model to size rural carrier support; (2) make a distinction between rural and non-rural carriers that both serve rural, high cost areas; (3) rebase the cap on the HCL fund, or eliminate the cap on the HCL fund entirely; (4) establish an above-the-cap "Safety Net Additive" mechanism to reimburse rural carrier investment in Total Plant in Service ("TPIS") accounts; (5) establish a "Safety Valve Mechanism" that removes the cap on support for acquired exchanges; (6) disaggregate support to multiple areas below the wire

center level; (7) adjust the corporate operations expense limitation to reflect growth; (8) adopt a "no barriers" to advanced service policy.

In its endorsement of an embedded cost model to size the rural carriers' universal service support, the Rural Task Force is encouraging economic inefficiencies and creating barriers to competition – two results that a forward-looking cost model would avoid. A forward-looking cost model ensures that support for rural carriers accurately reflects the true cost of providing universal service, thereby encouraging competition in rural areas and promoting efficiency in the provision of universal service. In addition, the use of a forward-looking cost model is consistent with the objectives of the Act and the FCC's previous universal services orders, while an embedded cost model is not.

The universal service funding mechanism should make no distinction between rural and non-rural carriers in the type of cost mechanism used to size the fund or in the method of disaggregating support to the carriers. Since both rural and non-rural carriers serve high cost areas, both rural and non-rural carriers should be subject to a unified universal support mechanism which ensures that support is disaggregated and targeted to the high cost areas that need the funding the most.

Furthermore, the Commission should not adopt the proposals of the RTF and the MAG to disaggregate support to multiple areas below the wire center level. Although the disaggregation of support ensures efficiency and that the distributed support is cost-based, both of the proposals before the Commission lack necessary regulatory oversight, and provide rural carriers with both an opportunity and an incentive to “game” the Universal Service system.

The Commission should not remove the cap on Universal Service support for transferred/sold exchanges. This safeguard was established by the Commission to eliminate any incentive for carriers to acquire exchanges based upon potential Universal Service support. Until the support mechanism for rural carriers is based upon forward-looking economic cost (“FLEC”) principles, the Commission should not consider abandoning its previous determinations and should maintain the cap on Universal Service support for transferred/sold exchanges.

There is no record support for re-basing - or eliminating - the indexed cap on the High Cost Loop Fund or increasing the size of the fund. Both the RTF and the MAG have failed to provide any demonstration that the current level of support is insufficient to support the universal service goals identified in the Telecommunications Act of 1996 and the Commission’s previous orders. Accordingly, the Commission should reject all of the recommendations to increase the current level of universal service support.

Instead, the Commission should adopt an annual productivity factor to be applied to the indexed cap on the HCL fund. This productivity factor will re-base downward the cap on the HCL fund to reflect the known productivity increases in the telecommunications industry since the adoption of the indexed cap

The RTF’s “Safety Net Additive” mechanism is flawed because it does not ensure that funding is being directed to a service supported by Universal Service.

The RTF has provided no evidence that an overall increase in Total Plant in Service ("TPIS") investment will guarantee an increase in the quality and availability of services currently supported by Universal Service. In addition, the proposal would inappropriately award Safety Net Additive support in all succeeding years, regardless of whether a carrier met the investment threshold requirement. Accordingly, the Commission should reject the RTF's proposed Safety Net Additive mechanism.

The core services supported by the universal service fund must be clearly defined and limited to those services that meet the requirements established by the Commission and, more importantly, the statutory standards established in the Act. The Rural Task Force's recommendation to expand support for advanced services facilities violates the standard in the Communications Act, is beyond the scope of this proceeding, and lacks any factual or analytic basis.

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COMMENTS

The Ad Hoc Telecommunications Users Committee ("Ad Hoc" or "the Committee") hereby submits its Comments in response to the Commission's January 12, 2001 Further Notice of Proposed Rulemaking[1] seeking comment on the Recommended Decision of the Federal-State Joint Board on Universal Service ("Joint Board") regarding the Rural Task Force's ("RTF's") recommendation to reform the rural universal service support mechanism, [2] and

[1] *Federal-State Joint Board on Universal Service*, CC Docket 96-45, FCC-01-8, *Further Notice of Proposed Rulemaking,* (rel. January 12, 2000) ("*RTF FNPRM*").

[2] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, FCC 00J-4, *Recommended Decision,* (rel. December 22, 2000).

the Commission's January 5, 2001 Notice of Proposed Rulemaking[3] seeking comment on the petition of the Multi-Association Group ("MAG") to reform interstate access and universal service support policies for ILECs subject to rate-of-return regulation.[4]

INTRODUCTION

Ad Hoc's members are among the nation's largest high-volume consumers of telecommunications services and facilities. The Committee is therefore committed to the development of regulatory rules and policies that promote the availability of high quality telecommunications services and facilities at reasonable prices. To that end, Ad Hoc has consistently supported universal service subsidies as long as those subsidies are properly sized, collected, and distributed in an economically efficient and pro-competitive manner.

Ad Hoc urges the Commission to reject many of the recommendations of the RTF and the MAG, because they would harm ratepayers and the public interest. Collectively, the recommendations of the RTF and the MAG would not reflect an appropriate quantitative assessment or efficient use of universal service support, and would discourage the emergence of competition in the rural and high cost areas of the country.

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3 *Federal-State Joint Board on Universal Service*, CC Docket 00-256; CC Docket 96-45; CC Docket 98-77; CC Docket 98-166, FCC-00-448, *Notice of Proposed Rulemaking* (rel. January 5, 2001).

4 Petition for Rulemaking of the LEC Multi-Association Group, RM No. 10011, filed October 20, 2000 ("MAG Petition"). 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).

I. A FORWARD-LOOKING METHODOLOGY IS ESSENTIAL FOR RURAL CARRIERS.

Universal Service support for rural carriers is currently calculated using a rural carrier's embedded costs. In the 1997 *Universal Service Order*, the Commission determined to

> allow rural carriers to continue to receive support based on embedded costs for at least three years. Once a forward-looking economic cost methodology for non-rural carriers is in place, we shall evaluate mechanisms for rural carriers. Rural carriers will shift gradually to a forward looking economic cost methodology to allow them ample time to adjust to any change in the support calculation.[5]

No material changes have occurred in the Universal Service environment since that determination was made. A forward-looking economic cost ("FLEC") model was approved for non-rural carriers last year.[6] Accordingly, the purpose of this proceeding should be to determine the appropriate FLEC methodology to size rural carrier universal service support.

Instead of continuing down the well-reasoned path that the Commission has already adopted, however, the RTF has recommended (and the Commission is seeking comments upon) a proposal to rely on embedded costs for rural carriers, using the Modified Embedded Cost Mechanism.[7] But a FLEC methodology remains the economically appropriate approach to sizing rural carrier support. The RTF's recommendation to use an embedded cost model is

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[5] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report and Order* 12 FCC Rcd 8776, 8936 (1997) ("*Universal Service Order*").

[6] *Federal-State Joint Board on Universal Service*, CC Docket 96-45*, Ninth Report and Order and Eighteenth Report on Reconsideration*, 14 FCC Rcd 20439 (1999).

[7] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45*, RTF Recommendation to the Federal-State Joint Board on Universal Service* (rel. September 29, 2000) ("*RTF Recommendation*") at 20.

inconsistent with previous Commission determinations in CC Docket No. 96-45 and with the specific task assigned to the RTF by the Joint Board. Ad Hoc urges the Commission to reject both the Rural Task Force's recommendations and the MAG Petition's recommendations to continue reliance upon embedded costs.

A. A Forward-Looking Methodology Encourages Efficient Investment And Eliminates Anti-Competitive Pricing Structures

As Ad Hoc pointed out in earlier universal service proceedings,[8] any reliance on a carrier's embedded costs to determine universal service support rewards inefficient past investment decisions and obstructs the development of competition. The use of a FLEC model, on the other hand, ensures that support levels correspond to the true cost of providing universal service and thereby both encourages competition in rural areas and promotes efficiency in the provision of universal service.

In the *Universal Service Order*, the Commission supports the use of a FLEC model as an appropriate tool for calculating universal service support and finds that an embedded cost model rewards carriers for making past inefficient investments:

> The use of embedded cost would discourage prudent investment planning because carriers could receive support for inefficient as well as efficient investments. The Joint Board explained that when "embedded costs are above forward-looking costs, support of embedded costs would direct carriers to make inefficient investments that may not be financially viable when there is competitive entry." The Joint Board also explained that if

[8] *See, e.g.,* Reply Comments of Ad Hoc Telecommunications Users Committee, CC Docket No. 96-45, filed May 7, 1996; and Comments of the Ad Hoc Telecommunications Users Committee, CC Docket No 96-45, filed December 19, 1996.

> embedded cost is below forward-looking economic cost, support based on embedded costs would erect an entry barrier to new competitors, because revenue per customer and support, together, would be less than the forward-looking economic cost of providing the supported services. [9]

Furthermore, the Commission concurred that "the use of forward-looking economic costs will lead to support mechanisms that will ensure that universal service support corresponds to the cost of providing the supported services, and thus will preserve and advance universal service and encourage efficiency because support levels will be based on the costs of an efficient carrier." [10] If adopted, the RTF's recommendation to continue using embedded costs to size Universal Service support for rural carriers would impede competition and encourage inefficient investment. Ad Hoc urges the Commission to stand by its previous determination, and to complete the intended transition of the rural carriers' support mechanism to a FLEC methodology. The RTF has provided no compelling evidence that could justify the delay in adoption of a FLEC methodology or the continuation of the use of embedded costs to determine rural carrier universal support.

The RTF provided no financial or economic data demonstrating that rural LECs would be unable to fulfill their USF responsibilities under the funding levels that would result from the use of a FLEC model. The Rural Task Force's recommendation to continue using embedded costs appears to be based upon little more than a knee-jerk reaction to the fact that the *total* level of funding that would be produced would be lower, rather than relying on some empirical

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[9] *Universal Service Order* at 8901 (footnote omitted).

analysis of the impact of the change in funding level on the availability of universal service.

Since no evidence whatsoever was provided in the filings of either the RTF, the Joint Board, or the MAG plan proponents (nor the comments filed by others in those proceedings), Ad Hoc attempted to ascertain on its own what the impact of changed funding might be; whether the carriers obtaining funding based upon existing embedded funding levels appeared to need such funding based upon earnings results; and whether the infrastructure deployment plans of the same rural LECs offered any insight into what sort of investments were being made. Ad Hoc's research revealed that there was no one source, or even combination of sources, that offers access to such data; in fact, the data apparently is not collected at all. Rural carriers are not required to file Form 492 Rate of Return reports with the Commission nor are they are required to file ARMIS reports documenting either financial results or infrastructure deployment. While it is possible that the Joint Board is still capturing data related to NTS plant costs and average cost per loop (the basis for embedded funding of USF), that data has not been included as part of their annual Monitoring Report since year-end 1996.

A review of a variety of State commission web sites was similarly disheartening. While some did appear to collect and synthesis financial and infrastructure data in a consistent manner for all carriers operating in a state, none that Ad Hoc encountered offered data in a format that allowed a meaningful

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[10] *Universal Service Order* at 8899 (footnote omitted).

evaluation of whether the full level of USF funding being received was necessary in order for the rural carriers to continue providing service at affordable rates throughout the rural carrier's service areas.

The sources Ad Hoc consulted are displayed in the table below.

Resources that do not track financial information for Rural carriers
Federal Communications Commission: www.fcc.gov
FCC form 492
Federal-State Joint Board Monitoring Report, 9/00
Automated Reporting Management Information System (ARMIS), 1999
Contacted Industry Analysis Division of the Federal Communications Commission
Universal Service Administrative Company: www.universalservice.org
Contributing Factors & Quarterly Administrative filings, 1st Quarter 2001.
United States Department of Agriculture: www.usda.gov
Rural Utility Service
National Exchange Carrier Association: www.neca.org

If the Commission nevertheless determines that the logic underpinning its previous determination to use a FLEC model for universal service support levels was somehow flawed, Ad Hoc urges the Commission to evaluate whether the existing levels of funding based upon the old embedded cost methodology are necessary for the support of universal service. Moreover, prior to instituting any changes that would increase the level of that funding, even using an embedded cost methodology, the Commission should institute reporting requirements that will allow it to evaluate the validity of any such increases for individual carriers.

B. The RTF Recommendation To Use An Embedded Model Is Inconsistent With Previous Commission Determinations and With The Task Assigned To The RTF By The Joint Board.

The FCC previously determined that a forward-looking model is the appropriate mechanism to determine rural carrier support. In the *Universal Service Order*, the Commission ruled that:

> In addition, we find that the use of mechanisms incorporating forward-looking economic cost principles would promote competition in rural study areas by providing more accurate investment signals to potential competitors. Accordingly, we find that, rather than causing rural economies to decline, as some commenters contend, the use of such a forward-looking economic cost methodology could bring greater economic opportunities to rural areas by encouraging competitive entry and the provision of new services as well as supporting the provision of designated services. Because support will be calculated and then distributed in predictable and consistent amounts, such a forward-looking economic cost methodology would compel carriers to be more disciplined in planning their investment decisions.[11]

The RTF's recommendation to use an embedded cost model is not only inconsistent with previous determinations in this docket but it is also at odds with the task assigned to the RTF by the Joint Board.

> Consistent with the Commission's recommendations, the Joint Board hereby announces the creation of a RTF. The RTF will focus solely on studying the establishment of a forward-looking economic cost (FLEC) mechanism for rural telephone carriers. Specifically, the RTF will consider whether a FLEC mechanism for rural carriers should have different platform design features or input values than the mechanism adopted for non-rural carriers.[12]

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[11] *Universal Service Order* at 8935-36 (footnote omitted).

[12] Federal-State Joint Board on Universal Service Announces the Creation of a Rural Task Force; Solicits Nominations for Membership on Rural Task Force, CC Docket No. 96-45, Public Notice, 12 FCC Rcd 15752 (1997) ("*Public Notice: Creation of RTF")*

Thus, the RTF's recommendation is, in effect, an attempt to obtain FCC reconsideration of a final determination in the absence of any basis for changing that determination. Ad Hoc urges the Commission to stand by its previous determination that a forward-looking model is the appropriate model for sizing universal service support, for all of the reasons identified by the Joint Board and the Commission in their prior decisions on universal service funding.

C. Inputs That Reflect The Unique Characteristics of Rural Carriers Can Be Used In A FLEC Model.

Rural-specific inputs can be developed and incorporated into a FLEC model. The RTF simply did not fulfill its mandate to evaluate whether or not the "FLEC mechanism for rural carriers should have different platform design features or input values than the mechanism adopted for non-rural carriers."[13]

Rather than evaluating platform design features or input values, the RTF rejected the use of the Synthesis Model used by non-rural carriers. In support, the RTF's fourth white paper provides a detailed description of the differences between rural-specific inputs and the inputs used in the non-rural carrier's support mechanism.[14] The RTF attempts to illustrate that the Synthesis Model is an inappropriate tool for sizing rural carriers' support by comparing the level of rural carrier support that would be calculated using the Synthesis Model's *non-*

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[13] *See*, *Public Notice: Creation of RTF*.

[14] *RTF White Paper 4*, *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, September 2000 ("*RTF White Paper 4*") at 34-38.

rural method (and *non*-rural inputs) to the current level of rural carrier support.[15] The RTF thus fell far short of its responsibility to develop rural-specific inputs for the Synthesis Model – or for any FLEC model. In one instance, the RTF cites that it made "a limited attempt to gather data from sample companies" but was unsuccessful in gathering any sample results.[16] The Commission must not allow the ILECs' reluctance to cooperate to derail the Commission's FLEC initiative: these carriers have been opposed to the use of a FLEC from the very beginning of the process.

Nor has the RTF demonstrated that a thorough analysis and evaluation of rural specific inputs was completed. The RTF was asked by the Joint Board to evaluate rural-specific inputs for a FLEC mechanism, and returned to the Joint Board with not only an abandonment of FLEC principles but additional modifications that conflict with efficient development of competition. The Commission should reject the modified embedded cost model proposed by the RTF as an inappropriate model for developing rural carrier support. Rural specific inputs and a FLEC model remain the appropriate tools for calculating rural carrier costs.

Absent the development of the rural specific inputs that should have been developed by the RTF, the Commission must devise a method for moving the use of the FLEC model forward. It should either (a) instruct the RTF to revisit the

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[15] The RTF includes rural carriers in the support calculation for the determination of explicit support. Applying the non-rural method (and non-rural inputs) for support calculations to both non-rural and rural carriers produced a support level for rural carriers that was $1,102-million less than the current level of support for rural carriers. *RTF White Paper 4*, at 6.

[16] *RTF White Paper 4*, at 35.

development of rural specific inputs for a FLEC model with a corresponding plan to use the non-rural FLEC inputs if the rural carriers refuse to cooperate with the RTF; or (b) issue another notice in this proceeding, establishing an additional phase that would calculate rural carrier universal support using the non-rural carrier specific inputs and the non-rural carrier model, absent an evidentiary showing by rural carriers that specific alternative inputs should apply.

II. SPECIFIC COMPONENTS OF THE RTF'S RECOMMENDATION AND THE MAG PETITION ARE FUNDAMENTALLY FLAWED

A. The Impacts of The RTF Recommendation And MAG Petition Must Be Quantified Before Further Consideration As Viable Solutions

Neither the RTF Recommendation nor the MAG Petition includes an adequate quantification of their potential impacts on Universal Service funding requirements. Adequate quantification is essential before the Commission can make any valid determination as to the reasonableness of these proposals.

The RTF recommends several modifications to the existing universal support mechanism for rural carrier support that will result in an increase of the overall universal service fund for rural carriers. Specifically, the RTF recommends that the Commission (1) rebase the HCL cap and grow it by a Rural Growth Factor; (2) establish a "Safety Net Additive;" (3) adjust the corporate operations expense limitation to reflect growth; (4) create a "Safety Valve Mechanism;" (5) adopt a "no barriers" to advanced service policy; (6) and create a High Cost Loop Fund III.

In the *FNPRM*, the Commission seeks comment on whether the RTF's recommended level of universal service support is sufficient.[17] Since the RTF has not demonstrated that the recommended level of support is necessary or sufficient, the Commission cannot conclude that they are; indeed, since the recommendation is to increase funding, the Commission could conclude that the recommended level of support is unreasonably generous. At a minimum, the Commission must require the RTF to quantify the separate impact of each of its recommendations on the size of the universal service fund and the actual need of recipient carriers that would receive additional funding beyond that available using a FLEC model. The RTF must also demonstrate that the current level of funding is insufficient and that the quantified increase is necessary to ensure affordable rates for all consumers.

B. No Methodological Differences In The Treatment Of Rural And Non-Rural Carriers Have Been Justified

Ad Hoc urges the Commission to adopt the same methodological principles to establish support mechanisms for rural and non-rural carriers who both serve rural, high cost areas. In the Telecommunications Act of 1996 ("1996 Act"), the Commission was directed to take the necessary steps to establish support mechanisms to ensure the delivery of affordable telecommunications service to all Americans. Specifically, the Commission was instructed to devise mechanisms that guarantee to all individuals in the United States, including low-income consumers and those in rural, insular, and high cost areas, access to

[17] *RTF FNPRM* at ¶ 4.

affordable telecommunications services at rates that are reasonably comparable to rates charged for similar services in urban areas.[18]

The 1996 Act makes no distinction between rural and non-rural carriers when establishing the universal service guidelines. The 1996 Act requires no disparate treatment of rural and non-rural carriers when it directs the Commission to establish "explicit and sufficient" support for universal service or when it specifies which carriers must contribute to the fund.[19] Those portions of the RTF recommendations that would differentiate between rural and non-rural carriers are not required by the principles of the 1996 Act and should be rejected by the Commission.

Obviously, there exist clear distinctions between rural and non-rural *areas* in the United States. Among other things, rural areas in the United States are characterized by low population densities, low levels of average income, and higher costs. Nonetheless, rural areas in the United States are served by *both* rural and non-rural telecommunications carriers.[20] Ad Hoc urges the Commission to recognize that rural, high cost areas are defined by their unique characteristics and not by the size of the companies that serve them, and to reject any universal service policies for rural and non-rural carriers alike, that do not reflect or incorporate this concept.

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[18] 47 U.S.C. § 254(b)(3).

[19] 47 U.S.C. § 254(d)-(e); § 214(e).

[20] *See, e.g.,* California Comments, CC Docket 96-45, November 2, 2000, at 3; New York State Department of Public Service, et al. Comments, CC Docket 96-45, November 3, 2000, at 4; Qwest Comments, CC Docket 96-45, November 3, 2000, at 3.; Ad Hoc Reply Comments, CC Docket 96-45, November 30, 2000, at 8-9.

The RTF proposes to distinguish between rural and non-rural carriers in its recommendations to (1) use an embedded cost model to size the rural carriers' support; (2) disaggregate rural carriers' support differently from non-rural carriers' support; (3) create an additional, above the cap "Safety Net Additive" for rural carriers; (4) establish a "Safety Valve Mechanism; (5) and support investment in advanced services for rural carriers. As a result of these distinctions between rural and non-rural carriers, implementation of the RTF Recommendation may well impede the development of competition in high cost areas.

To ensure that high cost areas served by *both* rural and non-rural carriers receive sufficient universal service support, and that competition in these areas is not obstructed, it is necessary for the Commission to reconcile the rural and non-rural universal service methodologies. If two different universal service mechanisms are used for rural and non-rural carriers, universal support will be provided based upon the nature of the carrier and not the customer. The purpose of universal service support is to protect the interests of *customers* living in high cost areas, not the pecuniary interests of their carriers. While it may well be appropriate to incorporate rural carrier specific inputs into a FLEC model for rural carriers in order to protect the interests of their customers, there has been no evidence provided in the proceedings to date that establish that anything more is required.

If the rules do not discriminate between rural and non-rural carriers, universal service support can be disaggregated and targeted to the high cost areas that need it the most, regardless of the nature of the serving carrier.

Rather than adopt the RTF Recommendation, which will exacerbate the differences in the treatment of carriers serving similarly situated customers, Ad Hoc urges the Commission to rely upon a FLEC mechanism to size rural carrier support and to ensure that the disaggregation of support for both rural and non-rural carriers is consistent.

C. The Cap On The HCL Fund Should Not Be Re-Based Or Eliminated.

One of the RTF's recommendations is to re-base the indexed cap on HCL support and increase the corporate operations limitation, which will result in an increase to the current HCL Fund of $118.5 million.[21] The MAG Petition proposes that the indexed cap on the HCL fund be completely eliminated.[22] Ad Hoc strongly disagrees with both of these proposals and urges the Commission to maintain the existing indexed-cap on the HCL fund.

The Commission prescribed the current indexed cap on the HCL fund to "encourage carriers to operate more efficiently by limiting the amount of support they receive" in the period preceding the rural carrier's transition to a forward looking methodology.[23] Any increase in the existing cap – and certainly the proposal in the MAG Petition to eliminate the cap – would reduce or void all incentives for rural carriers to be efficient in their investment decisions. Coupled with the RTF's recommendation to rely on a carrier's embedded costs to size the

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[21] *RTF Recommendation* at 4.

[22] *MAG Petition* at 4.

[23] *Universal Service Order* at 8940.

rural carriers' support, any increase or elimination of the indexed cap on the HCL Fund would only encourage a rural carrier to make inefficient investment decisions with the knowledge that the costs of those investment decisions will be recovered in their entirety under the embedded cost model. Indeed, such an increase or elimination of the cap will re-introduce a guaranteed cost recovery mechanism, which rewards poor judgment and wasteful investment. The continuation of the existing indexed cap, on the other hand, will encourage efficient investment by rural carriers and will not obstruct the development of competition.

In addition, the RTF and the MAG Petition do not provide any analysis to justify an increase in the size of the HCL Fund. There is simply no evidence that the current level of the Universal Service support is insufficient or inadequate to provide the necessary support to rural carriers. Until the Commission is presented with a factual and persuasive record of insufficient universal service funding to rural carriers, the Commission should reject any attempt to increase the fund.

D. The Commission Should Apply An Annual Productivity Factor To The Indexed Cap On The HCL.

While there is no record evidence in the Joint Board proceeding that the existing HCL cap is providing an inadequate level of support, there is ample evidence that the *cost* of providing the services being funded by the dollars subject to the cap have been declining. Therefore, rather re-base the cap to accommodate *an increase* and allow the level of HCL funding to continue to *grow* over time, the Commission should take this opportunity to do exactly the opposite. The HCL cap should be re-based downward to reflect the known productivity increases in the telecommunications industry during the period between 1994, when the fund was capped,[24] and the present. Moreover, going forward, the funding allowed under the cap should be reduced by a factor that is the equivalent of the "X-factor" used by the FCC in its Price Caps plan.[25]

Tier 1 LECs subject to the FCC's price caps plan have been subject to a 6.5% "X-factor" since 1997. Ad Hoc proposes that the same "X-factor" formula (GDPPI – "X") be applied to reduce the HCL cap going forward.

E. The Commission Should Reject The RTF's Recommendation To Eliminate The Cap On Universal Service For Transferred/Sold Exchanges

The Commission should reject the RTF's recommendation to establish a "Safety Valve Mechanism" that removes the cap on the universal service subsidy level for an acquired exchange.[26] Under this RTF recommendation, rural carriers will receive the support transferable under current rules,[27] and fifty percent of any

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[24] *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket 80-286, 9 FCC Rcd 303 (1995).

[25] The FCC established an "X" factor designed to reflect the fact that telephone services exhibit a higher level of productivity than the US economy in general. The "X" factor was last set at 6.5%, and although that "X" factor was remanded to the FCC, it was stipulated to by the majority of the Tier 1 LECs as part of the recent CALLS proceeding. See *Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262* ("*Fourth Report and Order*") and *Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45* ("CALLS Order"), 15 FCC Rcd 12962 (2000).

[26] *RTF Recommendation* at 27.

[27] 47 C.F.R 54.305

positive growth in the annual expense adjustment.[28] The RTF estimates that the removal of this cap will result in an initial increase of $12.8-million in universal service support for rural carriers.[29]

In the *Universal Service Order*, the Commission ordered that until rural carriers transition to a new forward-looking support mechanism, all acquired exchanges will receive the same level of support per line as the seller received prior to the sale/transfer.[30] This safeguard was established to eliminate the possible incentive for a carrier to acquire exchanges based upon potential Universal Service support. If a non-rural carrier sells/transfers an exchange to a rural carrier and the universal support for the acquired exchange is based upon a FLEC model, than the acquiring rural carrier will receive support based upon the FLEC model and not the embedded costs of the access lines in the exchange.

The preventive measure of capping Universal Service support for transferred exchanges was established by the Commission to ensure that the transfer of an exchange was not unduly influenced by potential Universal Service support. If the Commission were to now eliminate the cap on Universal Service support for transferred exchanges, and adopt the Safety Valve Mechanism as proposed by the RTF, the Commission would be creating an incentive for carriers to "game" the Universal Service system. Ad Hoc believes that the appropriate time for the Commission to review and assess the validity of the cap on the

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[28] The RTF recommends that the study area's HCL expense adjustment be calculated at the end of the first year – this becomes the "index year expense adjustment." At the end of each subsequent year, the HCL expense adjustment is calculated, and compared to the "index year expense adjustment." See, *RTF Recommendation*, Appendix D.

[29] *RTF Recommendation* at 21.

[30] 47 C.F.R. 54.305; *Universal Service Order* at 8942.

Universal Service for transferred exchanges, is at such a time when rural carriers have completely transitioned to a forward-looking support mechanism.

The RTF's recommendation includes a requirement that all Safety Valve support for rural carriers will not exceed 5% of the indexed HCL fund cap. In the *FNPRM*, the Commission seeks comment on how support should be distributed if it is to exceed the 5% cap of the HCL Fund.[31] For the reasons stated above, the Safety Valve Mechanism should not be adopted. However, if the mechanism is adopted by the Commission, the actual application of the mechanism should be transparent and the 5% cap on Safety Valve support for rural carriers should be maintained.

Furthermore, the Safety Valve Mechanism, as proposed by the RTF, does not ensure Universal Service support for specific infrastructure investment or improvements in services currently supported by universal service. The *FNPRM* seeks comment on what the definition of "meaningful investment" should be.[32] Again, Ad Hoc's opinion is that the Safety Valve Mechanism is flawed and should be rejected by the Commission. However, if the Commission decides to adopt the Safety Valve Mechanism, the types of investment that will be reimbursed by this mechanism must be explicitly identified. Specifically, the mechanism *should not* recover investments in services that are not currently supported by universal service.

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31 *RTF FNPRM* at ¶ 5.

32 *Id.*

F. The Commission Should Reject The RTF's Recommendation to Establish a Safety Net Additive Mechanism.

The RTF's "Safety Net Additive" is flawed because it does not tie support to any particular service supported by Universal Service. Instead, the RTF recommends that the Commission adopt an above-the-cap Safety Net Additive mechanism to reimburse rural carrier investment in Total Plant in Service ("TPIS") accounts.[33] For any rural carrier with an annual TPIS increase of at least 14 percent, the Safety Net Additive would reimburse 50 percent of the difference between the capped expense adjustment and the study area's uncapped calculated support. In addition, the RTF recommends that if a rural carrier meets the 14 percent investment requirement in any given year, it will automatically receive Safety Net Additive support in all subsequent years – regardless of whether or not it meets the annual 14 percent investment requirement. Adoption of this plan would result in the funding of rural carrier investment that may bear no relationship to the provision of Universal Service as defined by this Commission. It will also guarantee federal funding for rural carriers of a substantial portion of any investment that may be made for deployment of non-basic services – a level of federal funding that would not be available to non-rural carriers.

The RTF has not demonstrated that there is a correlation between TPIS investment and the services targeted for support through universal service funding mechanisms. An overall increase in TPIS investment does not

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[33] *RTF Recommendation* at 27.

necessarily indicate an increase in the quality and availability of services currently supported by Universal Service. In addition, Ad Hoc believes that the Safety Net Additive mechanism provides rural carriers with the incentive to inefficiently "inflate" their TPIS accounts to maximize their universal service support.

Furthermore, it would be inappropriate to award a rural carrier Safety Net Additive support in all succeeding years, regardless of whether or not the carrier meets the 14 percent threshold requirement. Under this proposed mechanism, a carrier would be allowed to recover Safety Net Additive support in years when it could *disinvest* in TPIS investment accounts.

Accordingly, Ad Hoc urges the Commission to protect the sufficiency and integrity of the Universal Service Fund by rejecting the RTF's proposed Safety Net Additive mechanism. The proposed mechanism does not adequately ensure that *only* supported services are being supported by the Universal Service Fund.

In the *FNPRM*, the Commission requests comments on whether or not the Safety Net Additive mechanism allows carriers to recover more than 100 percent of their incremental loop.[34] Based upon the limited information and explanation of this proposed mechanism provided by the RTF, Ad Hoc is unable to adequately evaluate and address the question raised by the Commission in the *FNPRM*. The mechanism may, in fact, permit rural carriers to recover more than 100 percent of their incremental loop costs. If the Commission adopts the Safety Net Additive mechanism as proposed by the RTF, the Commission must perform

[34] *RTF FNPRM* at ¶ 7.

a complete review of the mechanism's application and ensure that the mechanism will not reimburse more than 100 percent of the incremental loop.

G. The Commission Must Reject The RTF And MAG Proposals To Disaggregate Universal Service

Ad Hoc urges the Commission to reject the recommendations of the RTF and the MAG to disaggregate Universal Service support to multiple areas/zones below the wire center level. Although Ad Hoc supports the disaggregation and targeting of support to high cost areas, Ad Hoc does not believe that either of the proposals provide the necessary regulatory oversight to ensure the development of competition in rural areas.

Currently, the rural carrier's Universal Service support mechanism averages rural carrier support across all lines served by the rural carrier within the study area.[35] This methodology assesses equal, uniform support to all access lines in the study area, regardless of whether the access lines are deployed in a high cost area. In the *Universal Service Order*, the Commission determined that per line support is portable and that Competitive Eligible Telecommunications Carriers ("CETCs") entering or operating in an incumbent carrier's study area will receive support based upon the incumbent carrier's embedded costs.[36] The revisions proposed as part of the RTF Recommendation and the MAG Petition contain elements that appear to unduly disadvantage potential competitors to rural carriers. While there may be some debate as to whether the potential for

[35] RTF White Paper 6, *Disaggregation and Targeting of Universal Service Support*, September 2000 ("*RTF White Paper 6*"), at 5.

[36] *Universal Service Order*, at 8945.

competition to develop in rural areas is as great as in more urban areas, the Telecommunications Act of 1996 opened markets to competition, including those served by rural carriers.

The MAG proposes to allow LECs to disaggregate support among up to three zones per wire center, and to allow LECs to seek disaggregation for additional zones from the regulatory authority.[37] The RTF recommends that rural carriers be allowed to select one of three flexible paths of disaggregation.[38] A rural carrier can select the first path, where support *is not disaggregated or targeted*. Under the second path, the rural carrier submits a proposal for disaggregation to the state commission and, upon approval from the commission, the plan remains in place until replaced or revised. Finally, the third path allows rural carriers to self-certify a method of disaggregation to the wire center level, and to disaggregate to no more than two zones below the wire center. A rural carrier's self-certified plan under the third path would remain in place for at least four years.

Ad Hoc supports the disaggregation and targeting of support to high cost areas. Disaggregation and targeting of support ensures efficiency and that the distributed support is cost-based. However, the proposals of the RTF and the MAG contain significant flaws which must be corrected and require regulatory oversight of the disaggregation process to ensure that incentives do not exist for incumbent carriers to "game" the universal service support system. The system can not be structured to permit ILECs to disaggregate support areas in such a

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[37] *MAG Petition* at 15.

way that the competitive carriers' USF payments are reduced, even though the competitive carrier made valid business decisions to enter a specific geographic area based upon a particular level of Universal Service support per customer. The proposed plans as they exist appear to allow for such a scenario.

The RTF has established several basic guidelines that address the treatment of CETCs in study areas where the rural carrier elects to disaggregate:

- In areas served by Rural Carriers where a CETC has not submitted revenue producing lines to the federal universal service administrator in order to receive support, per line support available to the CETC would be determined pursuant to the disaggregation paths set forth in V(A).[39]

- In study areas where a CETC has been approved and the CETC is providing service, universal service support payments per loop to the ILEC and the CETC serving the same area should be the same and should be determined by freezing the ILEC support per loop. The disaggregated support per loop should be frozen based on the data for the twelve month period ending prior to the quarter in which the CETC first reports revenue-producing lines to the federal universal service administrator to receive support.[40]

- Once an additional ETC is designated and begins providing service in the Rural Carrier's study area, that per line support for both the ILEC and the CETC be frozen and grown by an annual RGF.[41]

Ad Hoc's first concern is with the method by which an *existing* CETC's per line support is determined under the RTF's recommendation to disaggregate. If a rural carrier elects to disaggregate support either through the second or third path, does an *existing* CETC's support payment mirror the rural carrier's newly

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[38] *RTF Recommendation* at 35-36.

[39] *RTF Recommendation* at 25.

[40] *RTF Recommendation* at 26.

[41] *RTF Recommendation* at 37.

determined disaggregated support? Rural carriers can not be allowed to determine the per-line support for CETCs operating in their study area.

Ad Hoc's second concern with the above guidelines is that they do not encourage competition. The RTF has chosen to address the issue of CETC support *only after* the incumbent rural carrier has selected a disaggregation method. Under the above guidelines*, all new – and possibly existing-* CETCs would receive the same level of support that the rural carrier receives through disaggregation. If a rural carrier is allowed to self-certify disaggregation to multiple cost zones below the wire center, as proposed by the RTF and the MAG Petition, the rural carrier has an incentive to target an excessive amount of funding to the areas/zones where a CETC is unable or unlikely to provide service, while targeting an inadequate amount of funding to areas/zones currently served or likely to be served by a CETC. Thus, the proposed method of disaggregation permits arbitrary decisions that can impede competition.

The Commission should not adopt the proposal to disaggregate to multiple areas/zones below the wire center, as presented by the MAG Petition and the RTF. If the Commission does adopt either of the proposals to disaggregate/target support to high cost areas, disaggregation should not occur below the wire center level and the method of disaggregation should not be arbitrary or based upon a rural carrier's self-certification. Instead, disaggregation should occur as a direct result of a regulatory review of the costs associated with each wire center. In addition, the Commission should clarify the difference (if any) between existing and new CETCs under a rural carrier's plan to disaggregate.

H. The Commission Should Adopt The RTF's High Cost Fund III And Apply An Annual Productivity Factor To The Fund Cap.

As a general proposition, Ad Hoc supports the proposed establishment of the High Cost Fund III (HCF III) which, like the CALLS plan before it, would move interstate access charges closer to economically rational levels. Presumably, a greater portion of the interstate share of subscriber line costs that are presently recovered via per minute prices would be recovered from the subscribers of those lines, the ultimate cost causers. Ad Hoc has always been a proponent of more economically rational pricing structures and, at least at a conceptual level, is in favor of the HFC III. Rural carrier access charges have long been set at levels that dwarf those of their non-rural counterparts. It is only appropriate that the implicit subsidies buried in those rates be removed and recovered elsewhere.

Ad Hoc is concerned, however, that transfer of the revenue requirement presently collected from rural carriers' per minute access charges to a fixed HCF III will freeze in perpetuity a revenue stream that should, by all economic measures and indicators, be declining over time. Therefore, consistent with the treatment recommended for the HCL fund, Ad Hoc recommends that if established, the new HCF III funding requirement be reduced by a factor equivalent to the "X-factor" used by the FCC in its Price Caps plan. As discussed above, Tier 1 LECs subject to the FCC's price caps plan have been subject to a

6.5% “X-factor” since 1997. The Commission should apply the same “X-factor” formula (GDPPI – “X”) to reduce the HCL III cap going forward.

III. UNIVERSAL SERVICE SUBSIDIES FOR ADVANCED SERVICES MUST BE ADDRESSED IN A SEPARATE PROCEEDING.

A. This Rural Specific Proceeding Is Not The Correct Procedural Forum For Re-Visiting the Definition of Supported Services.

The RTF proposed 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.”[42] Ad Hoc opposes the RTF’s recommendation because this rural-specific support proceeding is not the appropriate forum for re-visiting the definition of supported services. In order to base its decision on an adequate evidentiary record and to provide sufficient notice and an opportunity to comment, the Commission must consider the issue in a proceeding whose evidentiary record is not narrowly focused on the needs of rural customers.

B. The RTF Has Not Provided a Justification for Expanding the Current Definition.

The RTF has not provided a justification for expanding the current definition of supported services at this time to include the additional incremental facilities used to deliver advanced services. If and when circumstances warrant an expansion to include additional advanced services facilities, the Commission

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[42] *RTF Recommendation* at 4.

should begin a proceeding to consider both the statutory bases for doing so and the dollar impact on the fund and other beneficiaries of support, both carriers and customers.

C. Advanced Services Do Not Meet the Statutory Standard For Services To Be Supported By The Universal Service Fund.

The statutory considerations for classifying a service as eligible for Federal Universal Service support mechanisms do not justify support for advanced services. The Telecommunications Act of 1996 lists the factors that the Commission and the Universal Service Joint Board must consider in order to include a service in the definition of eligible services. The Commission must consider the extent to which services:

(A) are essential to education, public health, or public safety;
(B) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;
(C) are being deployed in public telecommunications networks by public telecommunication carriers; and
(D) are consistent with the public interest, convenience and necessity.[43]

Whether advanced services can meet the requirements listed above is a contentious and complex issue and Ad Hoc urges the Commission to pursue the discussion in an appropriate proceeding. The RTF in its recommendation has failed to provide any rationale or factual support for declaring that advanced services satisfy any of the above requirements.

[43] 47 U.S.C.§ 254(c)(1).

D. Universal Service Support For Advanced Services Does Not Ensure Advanced Service Deployment To Rural And High Cost Areas.

Ad Hoc believes that increased competition, not a higher subsidy level, is needed to ensure the availability of reasonably priced, high quality advanced services for rural and high cost areas. Indeed, the RTF's recommendation to support investment in rural infrastructure to produce 28.8 kbps access to the Internet may do more harm than good to rural America if it "bind[s] rural Americans to obsolete technology."[44] The RTF's recommendation to fund deployment of advanced services at this point in time is premature given the nascent state of both the technology and consumer interest in the service. Rather than engage in industrial policy, uninformed by consumer choices in the marketplace or the state of technology, the Commission should reject the RTF's recommendation and allow competitive markets to develop.

CONCLUSION

For the reasons discussed above, the Commission should stand by previous decisions to use a forward-looking methodology to determine universal service support for rural carriers. All carriers who serve high-cost areas, whether rural or non-rural, should benefit from the same allocation and disaggregation mechanisms. The proposals of the RTF and the MAG to disaggregate to multiple areas below the wire center level do not provide incentives for rural carriers to act in a pro-competitive manner, and lack the necessary regulatory oversight. The

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[44] *DigitalLouisinana.org Comments*, CC Docket 96-45, November 3, 2000 at 4.

RTF's recommendations to establish a Safety Net Additive and a Safety Valve Mechanism are flawed and should be rejected by the Commission. Any expansion of the subsidies for advanced services should be considered in a procedurally appropriate forum based on an adequate record. Rural carrier incentives to operate efficiently should not be compromised by any re-basing or re-sizing of the High Cost Loop Fund. Finally, a productivity factor should be applied to both the indexed cap on the High Cost Loop Fund and the RTF's recommended High Cost Loop Fund III.

Respectfully submitted,

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200.14/RTF/COM final 2_26_01.doc
96-45: 2001226727810
98-77: 2001226392496

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I, Victoria Curtis, hereby certify that true and correct copies of the preceding Comments of the Ad Hoc Telecommunications Users Committee were served this February 26, 2001 via the FCC Electronic Comment Filing System and were deliverd by hand upon the following party:

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February 26, 2001