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

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

TO: The Commission

COMMENTS OF THE WESTERN ALLIANCE

THE WESTERN ALLIANCE

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Dated: February 26, 2001

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SUMMARY

The Western Alliance supports the interstate access proposals in the Multi-Association Group ("MAG") Plan. These proposals will reduce for a time the uncertainty that has plagued the rural telephone industry for the past six years regarding the future of critical interstate access revenues, and will create an environment more conducive to the deployment of advance services in rural areas. At the same time, the MAG Plan affects well less than 10 percent of nationwide access lines and interstate access revenues, and will not have an adverse impact upon the interstate access costs or interstate long distance toll charges of interexchange carriers.

The Western Alliance has focused on four issues. First, the option for rural telephone companies and other local exchange carriers ("LECs") to remain on rate of return regulation (Path B) must be retained. The Commission has long recognized that price caps and other forms of incentive regulation are designed primarily for larger carriers having relatively stable investment patterns and operating expenses from year to year. In contrast, rural LECs differ significantly not only from larger LECs, but also from each other, in size, scale, network design, operating conditions, investment patterns and other relevant characteristics. Whereas only some Western Alliance members are likely to elect to remain on Path B, the flexibility to do so is essential for those rural LECs that are ill-suited for incentive regulation, particularly small LECs with "lumpy" investment patterns and significant year-to-year flucuations in operating expenses.

Second, the Western Alliance believes that the MAG Plan mechanisms should be implemented for an eight-year initial term. This reflects the longer time that it takes for rural LECs to finance and implement substantial infrastructure investments, and is consistent woth the eight-year transition periods for the original Universal Service Fund and for the 25 percent interstate allocation factor.

Third, the Western Alliance opposes the addition of any productivity offset to the proposed Revenue Per Line ("RPL") mechanism of Path A. Rural LECs do not have the size or operating scale to support X-factors or consumer productivity dividends like those developed for the large price cap carriers.

Finally, the Western Alliance believes that the Low End Adjustment mechanism proposed in the MAG Plan constitutes a safety net that is essential for the preservation of the investment capability and operating viability of those rural LECs on Path A that may experience sharp declines in their cash flow or earnings during a particular period.

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TO: The Commission

COMMENTS OF THE WESTERN ALLIANCE

The Western Alliance, by its attorney, hereby comments in response to the Commission's Notice Of Proposed Rulemaking, FCC 00-448, released January 5, 2001. The Western Alliance urges the Commission to adopt the interstate access reform proposals in the Multi-Association Group (MAG) Plan without significant modification, and to implement these proposals for a term of eight years. The Western Alliance also urges adoption of the Rural Task Force's (RTF's) Recommendation regarding universal service support, and is commenting separately in CC Docket No. 96-45 upon RTF proposals that address some of the same issues as the universal service proposals in the MAG Plan.

The Western Alliance supports the MAG Plan's interstate access reform proposals generally, but will focus its comments upon the following issues. First, the option for some local exchange carriers (LECs) to remain subject to rate-of-return regulation (Path B) must be retained in recognition of the fact that the size, network design and/or operating conditions of some carriers are wholly unsuitable for incentive regulation. Second, the term of the modified system should be long enough to accommodate the investment cycles of small carriers – preferably eight years rather than five years. Third, no "X-factor" or other consumer productivity dividend should be added to the proposed incentive mechanism (Path A), because small LECs do not possess the size, staff or scale to accommodate an annual productivity offset. Finally, the proposed Low End Adjustment mechanism should be included to encourage small carriers to adopt incentive regulation, and to protect them from the disruptive impacts of uncontrollable investment and cost fluctuations thereafter.

The Western Alliance

The Western Alliance is a consortium of the member companies of the Western Rural Telephone Association and the Rocky Mountain Telecommunications Association. It represents about 250 rural LECs operating west of the Mississippi River.

Western Alliance members are generally small LECs serving sparsely populated, high-cost rural areas. Most members serve less than 3,000 access lines overall, and less than 500 access lines per exchange. Their revenue streams differ greatly in size and composition from those of the price cap carriers. Most members generate revenues much smaller than the national telephone industry average, and rely upon interstate access and universal service dollars for 45-to-70 percent of their revenue bases.

At the same time, Western Alliance members incur per-customer facilities and operating costs far in excess of the national average. Not only does their small size preclude their realization of significant economies of scale, but also they serve remote and rugged areas where the cost per loop is much higher than in urban and suburban America. Their primary service areas are comprised of sparsely populated farming and ranching regions, isolated mountain and desert communities, and Native American reservations. In many of these high cost rural areas, the Western Alliance member not only is the carrier of last resort, but also is the sole telecommunications provider ever to show a sustained commitment to invest in and serve the area.

Western Alliance members are highly diverse. They did not develop along a common Bell System model, but rather employ a variety of network designs, equipment types and organizational structures. They must construct, operate and maintain their networks under a wide variety of climate and terrain conditions, ranging from the deserts of Arizona to the frozen tundra of Alaska, and from the valleys of Oregon to the plains of Kansas to the mountains of Wyoming.

Because of their significant reliance upon interstate access revenues, Western Alliance members have a clear and substantial interest in this and other Commission proceedings that may result in changes in the nature and amount of such revenues.

Western Alliance Position

The Western Alliance believes that the changing and converging telecommunications and information industries are making it increasingly essential for its members to bring advanced services (including broadband facilities) to their rural service areas. Whereas competition may develop in a handful of rural areas, it is not likely to come to a significant percentage of rural LEC study areas during the next five to eight years. Potential local service competitors will continue to focus primarily upon urban and suburban markets where business and other high revenue customers are concentrated and where profit opportunities are greater. Rather than competition, the primary driver of the deployment of advanced services in rural LEC study areas will be demands of rural residents for more rapid Internet access and other information services necessary for them and their children to participate more fully in the 21st Century economy.

Deployment of the infrastructure necessary to support advanced services is much more expensive in rural areas than in urban and suburban areas. The greater distances between customers in sparsely populated rural areas, by themselves, drive per-loop costs well up above the national average. For many rural LECs, costs are increased further by the need to construct and maintain loop facilities in the face of harsh weather conditions, rugged terrain, and/or inadequate transportation infrastructure. Finally, many Western Alliance members cannot provide interim Digital Subscriber Line (DSL) solutions to substantial portions of their service areas at this time, because their loop lengths and digital loop carrier facilities in such areas are not technically feasible for DSL. Put simply, Western Alliance members will have to make relatively large and risky investments to redesign and upgrade their networks to bring advanced services to their rural customers.

Unfortunately, during the very same period (1995 to the present) that the Internet explosion and voice/data/video convergence have generated increasing needs for network upgrades and advanced services, the future interstate access revenues and universal service support of Western Alliance members have been rendered very uncertain. A significant portion of this uncertainty arose from the Commission's 1995 inquiry regarding the Universal Service Fund (CC Docket No. 80-286), and from the various proceedings arising out of the Telecommunications Act of 1996 (including CC Docket Nos. 96-45, 98-77 and 98-166). Western Alliance members and other rural LECs simply cannot convince many of their owners, investors and lenders that they should proceed to make substantial infrastructure investments when faced with the possibility of changes in Commission rules affecting 45-to-70 percent of their existing revenue streams.

One of the primary advantages of the MAG Plan is that it should reduce the uncertainty of rural LECs regarding their future interstate access revenues during the period that it is in effect. Hence, at least for the next few years, Western Alliance members and other rural LECs will be better able to plan and finance infrastructure upgrades and the introduction of new advanced services on the basis of more reliable future revenue estimates.

Whereas the stability, sufficiency and predictability of the interstate access revenues at issue are extremely important to rural LECs and their rural customers, these same revenues constitute only a small portion of nationwide interstate access charges paid by interexchange carriers. The Commission itself has recognized that rate-of-return

LECs serve less than 8 percent of total U.S. access lines, and account for only an approximate 9 percent of total access revenues. Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, 13 FCC Rcd 14238, 14244 (1998). In other words, the Coalition for Affordable Local and Long Distance Service (CALLS) Plan adopted by the Commission in May, 2000 implemented access reform affecting more than 90 percent of access lines and access revenues, and thereby accomplished the lion's share of nationwide access reform. Hence, the Commission can deal with the access mechanisms and revenues that are extremely important to rural LECs in a careful and flexible manner, without adversely impacting the aggregate interstate access charges paid by interexchange carriers or their resulting long distance toll rates.

Path B Option

An essential element of this flexibility is the retention by the Commission of a rate of return regulatory option (Path B of the MAG Plan) for small LECs whose "lumpy" investment patterns and fluctuating operating expenses are not suitable for incentive regulation.

The Commission has long recognized that incentive regulation is not feasible for many small LECs. In its LEC Price Cap Order, 5 FCC Rcd. 6786, 6819 (1990), the Commission refused to force small LECs into a regulatory regime based largely on the historical performance of the largest telephone companies. Instead, it made price cap regulation optional for all companies smaller than the Regional Bell Operating Companies (RBOCs) and GTE. In Regulatory Reform for Local Exchange Carriers, CC Docket No.

92-135, 8 FCC Rcd 4545, 4546 (1999), the Commission noted that smaller LECs do not want to become subject to price cap regulation because:

> they cannot abandon the risk sharing provided by the NECA pools and the Long Term Support protection . . . without substantial risk to their continued financial viability. Others believe that, because of their small size, their business cycles are too long to comply with price cap annual adjustments and that the financial effect of facility upgrades is too great to be reconciled within the Commission's price cap framework.

The Commission repeatedly has taken into account the preference of small carriers for rate of return regulation when granting waivers of the "all-or-nothing" and "permanent choice" provisions of Rule 61.41 to permit rural LECs to acquire exchanges from price cap carriers without becoming subject to price cap regulation. See e.g., ATEAC, Inc., DA 009-1883, released August 18, 2000; Minburn Telecommunications, Inc., 14 FCC Rcd 14184 (1999); Maine Telecommunications Group, Inc., 9 FCC Rcd 3082 (1994); US West Communications, Inc. and Nemont Telephone Cooperative, Inc., 9 FCC Rcd 721 (1994); US West Communications, Inc. and South Central Utah Telephone Association, Inc., 9 FCC Rcd 198 (1993); and US West Communications, Inc. and Triangle Telephone Cooperative Association, Inc. et al., 9 FCC Rcd 202 (1993).

These principles apply equally to the incentive regulation mechanism (Path A) proposed in the MAG Plan. Whereas large and mid-sized LECs can rely upon their size, assets and scale economies to smooth out investment and expense fluctuations across their base of operations from year to year, small LECs have little or no protection against such fluctuations. For example, a larger LEC that operates hundreds of exchanges can plan and schedule upgrades in a specific fraction of these exchanges each year and maintain its infrastructure investment at a relatively stable level from year to year. In contrast, a rural LEC with three exchanges will experience a major fluctuation in its investment for the year that it upgrades one or more of its exchanges. Likewise, a larger LEC that operates hundreds of exchanges can readily offset significant expense increases in a handful of these exchanges with decreases in the operating expenses of its other exchanges or its administrative offices. Again, a substantial increase in the operating expenses of one of the small LEC's three exchanges will be virtually impossible to offset by decreases in other areas, and is likely to result in a significant jump in overall company expenses for the year.

Under incentive regulation, once a carrier's revenue per line is established, its investment and expenses need to remain relatively stable from year to year unless it has major reserves of liquid assets to insulate it against fluctuations. Many rural LECs do not have such asset reserves, and will be subject to disruptive cash flow shortages and earnings declines if fluctuating operating expenses and investment needs periodically exceed their incentive revenues. Rather than promoting rational investment and operations, the threats to a small LEC's financial viability from fluctuating or unpredictable costs under incentive regulation are far more likely to produce insufficient investment in new infrastructure and technologies, inadequate staffing and training, and degradation of technical and customer service.

This is **definitely not** to say that Western Alliance members will predominately elect Path B rate-of-return regulation over Path A incentive regulation. The Western Alliance has taken no survey of its members on this question. On the basis of general knowledge and experience regarding these members, the Western Alliance believes that as many as 30-to-60 percent of its approximately 250 members may elect Path A incentive regulation at some time if the MAG Plan is adopted substantially as proposed. The point here is that Path A incentive regulation is not a "one size fits all" solution for Western Alliance members, much less for all existing rate-of-return carriers. Rather, the Path B option needs to remain available for those LECs whose size, scale and fluctuating costs are not conducive to incentive regulation.

In its White Paper 2, 'The Rural Difference" (January 2000), the Rural Task Force (RTF) found that there are not only material and substantial differences between rural and non-rural LECs, but also significant diversity among rural LECs themselves. The differences among rural LECs include significant variations in study area sizes, customer densities, and terrain and climate conditions. As noted above, there is significant diversity among Western Alliance members in these and related areas. The Path B option recognizes this diversity, and offers a flexible alternative for those LECs that will not be able to provide adequate services and infrastructure to their present or future rural customers under incentive regulation.

The purpose and function of the existing system of rate-of-return regulation and National Exchange Carrier Association (NECA) pooling was to accommodate the differences among small LECs while maintaining stable rates for interexchange carriers and other access customers. The existing system enabled rural LECs to bring digital switching, single party service, fiber optic facilities, buried lines and other late 20th Century advances to their rural customers, often long before the RBOCs and GTE provided these features in neighboring rural exchanges. The Accounting Policy Division's (APD's) study area waiver files contain numerous examples not only of how rural LECs led their larger counterparts in bringing quality voice services to their rural customers, but also of how they purchased and upgraded long-neglected rural exchanges of larger carriers. See e.g. Union Tel. Co. and US West Communications, Inc., 12 FCC

Rcd 1840 (1997) (upgrade to digital loop carrier, install new cable, replace aerial wire) Pend Oreille Tel. Co. and GTE Northwest, Inc., 12 FCC Rcd 63 (1997) (upgrade to fiber, offer single party service, purchase CLASS-capable digital switch); and Accipiter Communications, Inc. and US West Communications, Inc., 11 FCC Rcd 14962 (1996) (install fiber, digital switch, extend service to unserved areas). The APD's study area waiver files also show that the promise and record of rural LEC upgrades resulted in vigorous support for these exchange acquisitions by state and local governments, local business communities, and rural residents.

The challenge now is for rural LECs to bring advanced services to Rural America. They can and will accomplish this, but will do so in the near term only if the Commission ends the six-year period of uncertainty regarding interstate access revenues and federal universal service support, and establishes sufficient and stable cost recovery mechanisms. For many small LECs, this means a rate-of-return mechanism like Path B that can accommodate their unique operating circumstances and the needs of their lenders, and not an incentive mechanism that raises fears that they will be not be able to generate sufficient cash flow to support infrastructure upgrades or other substantial future operating costs (both foreseen or unforeseen).

Finally, the Western Alliance notes that the potential aggregate cost of the Plan B option is minimal. We are talking here about a fraction of the access lines and access revenues of a group of carriers that, before many of its members elect Path A incentive regulation, serves less than 8 percent of total U.S. access lines, and receives only an approximate 9 percent of total access revenues. Put simply, on a national scale, the carriers electing to remain on Path B rate-of-return regulation will have no perceptible adverse impact on the total interstate access charges paid by interexchange carriers or on their resulting interstate toll rates. Hence, whereas the Path B option is very important for some small rural LECs and their rural customers, it will not harm interexchage carriers or their customers.

Term of the Plan

The term of the modified rate of return access mechanisms should be long enough to accommodate the normal investment cycles of small LECs. The Western Alliance does not oppose the five-year term proposed in the MAG Plan, but believes that an eight-year term would much more effectively promote the introduction of new advanced services and related infrastructure upgrades in rural areas.

Rural LECs simply cannot acquire and construct new facilities as rapidly as their larger counterparts. Rather, the financing, acquisition and installation of such facilities can take several years. First, unlike the RBOCs and other larger carriers, most rural LECs lack the cash reserves to self-finance significant infrastructure upgrades, as well as ready access to major commercial banks, the stock and bond markets, and venture capital funds. Rather, rural LECs must finance infrastructure investments via the generally more lengthy process of obtaining loans from the Rural Utilities Service, the Rural Telephone Finance Cooperative and CoBank. Second, rural LECs seeking to upgrade one or two exchanges at widely separated intervals rarely get the same prompt attention or early delivery from equipment vendors as larger carriers with continuing equipment acquisition programs or large orders. Rural LECs frequently wait at least four to twelve months for vendor delivery of equipment. Third, many rural LECs lack sufficient staff to undertake and complete major construction projects by themselves, but rather must contract with outside construction firms and wait for them the schedule the work. Finally, in major portions of the western states, the outdoor construction season lasts only a fraction of the year.

Because it can take several years for a rural LEC to commence and complete a major infrastructure upgrade, its incentive to undertake such a project will be reduced if the proposed mechanism for recovery of its costs has a term of only five years. In this regard, it is notable and relevant that the Commission employed eight-year transition periods to protect small LECs when it phased in the original Universal Service Fund and the 25 percent interstate allocation factor. MTS and WATS Market Structure, 50 Fed. Reg. 939 (December 1984).

Productivity Factor

As indicated above, a significant number of Western Alliance members are likely to elect Path A incentive regulation. For many of these carriers, the inclusion by the Commission of an X-factor or consumer productivity dividend in the Revenue Per Line (RPL) mechanism would cause major financial dislocations and hardship. The critical fact is that rural LECs do not have to size or operating scale to make the adjustments necessary to accommodate an annual productivity offset.

The typical Western Alliance member has a full-time staff of 10-to-15 employees, and some members have as few as four full-time employees. In contrast, Verizon's 1999 Annual Report indicates that it had a staff of 145,000 employees and SBC's 1999 Annual Report indicates that it had a staff of 204,530 employees.

Large carriers having large staffs like Verizon or SBC can increase productivity from year to year by a variety of devices, including reductions in force, increased specialization, consolidation of previously dispersed personnel or functions at a single office, sale of less profitable exchanges, and other measures. In contrast, rural LECs do not have similar capabilities or opportunities to realize productivity gains year after year. How can a rural LEC with a staff of 4-to-15 employees performing multiple administrative, technical and/or customer service functions at a single office increase its productivity by factor of 3, 5 or 7 percent per year for several years? Moreover, many rural LECs have already installed digital switches and in-house information systems, and consequently have little room to increase productivity by replacing employees with automated functions.

As noted above, the Commission did not impose price cap regulation upon small and mid-sized LECs because it could not reasonably subject them to a regulatory regime based largely on the historical performance of the RBOCs and other large carriers. LEC Price Cap Order, supra. A primary aspect of this decision was the inapplicability of the X-factor to small LECs. The Commission has no reason to depart from this wise policy, and should definitely **not** add any productivity offset to the RPL mechanism proposed in Path A of the MAG Plan.

Low End Adjustment

For Western Alliance members and other small LECs that elect Path A incentive regulation, it is critical that there be a safety net to preserve their ability to operate as their investments, revenues and/or expenses fluctuate significantly from period to period. The proposed Low End Adjustment (LEA) serves this function.

The Western Alliance recognizes that incentive regulation is supposed to be risky. However, the Commission must recognize that many rural LECs were the only entities that showed any perceptible interest in serving their areas during the 20th Century, and that many will continue in this role well into the 21st Century. The Commission must also recognize that substantial periodic investments in infrastructure, as well as uncontrollable events such as severe storms and relocations of major customers, can result in crippling shortfalls in cash flow and/or earnings for small carriers from time to time.

Large carriers possess the size, scale and financial resources to smooth their investment patterns by scheduling upgrades of specific portions of their exchanges each year, and to survive large and unforeseen expense increases for some of their exchanges. In contrast, rural LECs need a safety net like the LEA if they are to remain able to support periodic infrastructure upgrades and recover from weather damage and other major expense increases that reduce their cash flows or earnings. The LEA will allow small LECs to remain stable and financially viable in the face of these fluctuations without degrading the present service of the rural residents dependent on them, or reducing the investments necessary to furnish quality services in the future.

Conclusion

The interstate access reform proposals set forth in the MAG Plan constitute a well-reasoned and well-integrated package. The Western Alliance requests that they be adopted in their entirety and without significant modification, and that they be implemented for a longer term of eight years. The interstate access provisions of the MAG Plan will provide, for five-to-eight years, the increased certainty and flexibility essential for rural LECs to continue serving the rural areas dependent on them and to bring advanced services to these areas at a feasible date. The MAG Plan properly recognizes both the differences between large and small LECs and the differences among small LECs themselves, and proposes a flexible multi-path solution that will serve rural residents without significantly or adversely impacting the access costs or long distance toll rates of the interexchange industry.

The Western Alliance supports the access provisions of the MAG Plan in their entirety. In particular, it supports: (a) the option for rural LECs and other carriers to remain subject to rate-of-return regulation (Path B); (b) the adoption of the interstate access proposals of the MAG Plan for a term of eight years; (c) the use of a RPL incentive mechanism having an inflation adjustment but no productivity offset; and (d) the availability of a Low End Adjustment mechanism as a safety net for small LECs electing Path A incentive regulation.

Respectfully submitted,
THE WESTERN ALLIANCE

By Gerard J. Duffy
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Dated: February 26, 2001

CERTIFICATE OF SERVICE

I, Douglas W. Everette, hereby certify that I am an attorney with the law firm of Blooston, Mordkofsky, Dickens, Duffy & Prendergast, and that a copy of the foregoing **Comments of the Western Alliance** concerning the proposals of the Multi-Association Group to be served by first class mail or hand delivery this 26th day of February, 2001, to the persons listed below.

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