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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange 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

COMMENTS OF INNOVATIVE TELEPHONE

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February 26, 2001

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Summary

Access reform is necessary because the current access charge system is incompatible with today's marketplace. Innovative Telephone supports the adoption of the MAG plan as currently constituted. Eliminating the implicit subsidies in access charges is necessary to further universal service, a fact that Congress recognized in passing Section 254 of the Communications Act.

While the Commission's past efforts have focused on larger carriers, it is now time to turn to smaller, rate of return carriers. However, because of the diversity of circumstances facing smaller carriers, the Commission must be cautious in adopting reform, and must avoid a one-size-fits-all approach. Insular carriers, especially, face unique challenges in providing telecommunications service, such as isolation, weather, and topography.

As envisioned in the MAG petition, the MAG plan's flexibility strikes a balance between the goals of reforming access charges and the diverse needs of rural carriers by building in a substantial number of options, including the ability to choose incentive or rate-of-return regulation and the option to stay in or leave the NECA pool, either altogether or only for traffic sensitive elements. However, the MAG plan does not currently allow small carriers to recover their reasonable expenses in the event of catastrophic loss. In insular regions, hurricanes and tropical storms devastate telecommunications infrastructure with alarming frequency, and carriers need some method of recovering costs associated with these calamities. To be truly effective, the MAG plan should include a mechanism to allow for cost recovery. A simple and effective method for addressing this concern would be to modify the LEAF to allow carriers to recover up to the nominal 11.25% rate of return in the event of catastrophic loss.

The Commission should also reform the rules that discourage small carriers from acquiring and upgrading telephone exchanges, as the MAG plan proposes. The current cap on

universal service funds leaves acquiring carriers with inadequate support, and jeopardizes the requirements of Section 254.

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COMMENTS OF INNOVATIVE TELEPHONE

Innovative Telephone ("Innovative") (formerly known as the Virgin Islands Telephone Corporation),[1] by its attorneys, hereby submits these comments in response to the *Notice of Proposed Rulemaking*[2] requesting comment on the Petition for Rulemaking submitted by the Multi-Association Group (MAG).[3] Innovative applauds the Commission for putting the MAG

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[1] The Virgin Islands Telephone Corporation is doing business under the trade name "Innovative Telephone."

[2] *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, CC Docket No. 00-256, Notice of Proposed Rulemaking, FCC 00-448 (rel. January 5, 2001).

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

plan on public notice and for recognizing its close relationship to universal service reform. Although the FCC has taken steps to address the problems with the current access charge structure, to date the Commission's efforts have been focused on the largest carriers. It is now time to focus on smaller carriers and their customers in insular, rural and high-cost areas. The agency must address access charge reform for smaller carriers in a way that protects rural, insular, and high cost consumers, and not simply adopt the rules that are applicable to larger carriers.

As currently constituted, access charges contain implicit subsidies that support universal service. Implicit subsidies are incompatible with today's marketplace. Congress has recognized this fact, and in Section 254 of the Communications Act it required that such subsidies be replaced with an explicit universal service support mechanism. Therefore, the Commission is obligated to move forward with access charge reform.

At the same time, the FCC must be cautious in adopting a plan to modify the access charge structure as it applies to rate-of-return carriers. Rate-of-return carriers are a diverse group, comprised primarily of small and medium sized local exchange carriers ("LECs") who serve a range of insular, rural and high-cost areas. The challenges facing each of these carriers are in many ways unique. Thus, any access charge reform that the Commission adopts must take this diversity into account, and provide an array of options for carriers to choose from based on their individual circumstances.

As currently envisioned, the MAG plan addresses these concerns. Innovative thus supports enactment of the plan so long as its key features are retained. However, Innovative notes that a number of rural, insular and high-cost carriers are located in areas where harsh weather can destroy large sections of infrastructure in a singe stroke, and that the MAG plan does

not contain a mechanism to allow these carriers to recover their reasonable expenses in dealing with these calamities. This omission could prevent certain rural, insular and high-cost carriers from realizing all of the plan's benefits. In order for the MAG plan to be truly successful, it must incorporate a means for carriers to fairly recover catastrophic losses.

I. ELIMINATING IMPLICIT SUBSIDIES IN ACCESS CHARGES IS NECESSARY TO FURTHER UNIVERSAL SERVICE AND PROMOTE COMPETITION.

The MAG plan reforms access charges in line with Congressional goals that require the removal of implicit subsidies. Section 254 of the Communications Act directs the Commission to establish specific, predictable, and sufficient mechanisms to preserve and advance universal service.[4] Congress also "recogniz[ed] the vulnerability of implicit support to competition" and thus "directed the Commission . . . to create universal service mechanisms that would be sustainable in a competitive environment."[5]

Section 254 requires the Commission to replace implicit subsidies with explicit support mechanisms. Pursuant to Section 254, the Commission must develop a universal service program that is sufficient, predictable, and explicit.[6] The FCC has recognized that interstate access charges are a major source of implicit universal service subsidies,[7] and thus reform of interstate access charges to make those funds explicit is necessary to meet the requirements of

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[4] 47 USC §254(a), (d).

[5] *Access Charge Reform*, Sixth Report and Order in CC Docket No. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 at ¶ 190 (2000) ("*CALLS Order*").

[6] 47 USC §254(a), (d); *see also e.g.*, *CALLS Order* at ¶ 190.

[7] *CALLS Order* at ¶¶ 26, 185; *Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, 16144-50 (1997) ("*Access Charge Reform Order*").

Section 254.[8]

The MAG plan facilitates the Commission's efforts to comply with Section 254. The plan better rationalizes the access charge structure. It also provides for the recovery of shortfalls in non-traffic sensitive costs through Rate Averaging Support ("RAS") – an explicit, portable universal service mechanism. Thus, the MAG plan removes much of the implicit support from interstate access charges, shifting recovery to explicit support mechanisms and recovery directly from the cost causer.

Marketplace effects also necessitate replacement of implicit subsidies with explicit support mechanisms. The FCC must shift from implicit usage-based and business charge-based universal service support to explicit support to allow fair marketplace competition.[9] For example, the current access charge system inflates usage and business charges above the cost-based levels that the market would produce. As a result of these artificial regulatory pricing mechanisms, non-price cap carriers cannot fairly compete for many high-volume, low-cost business users. When deciding where to locate their businesses, for example, such users consider communications costs, among other things. Burdened by the existing access charge regime, non-price cap carriers risk losing these customers to carriers in urban or lower-cost areas, or to other carriers that can charge cost-based rates. Without such profitable, high-volume customers, an ILEC's cost of providing service to the remaining customers increases.[10] Explicit subsidies fairly charged to all telecommunications carriers are the only way to eliminate this unfair competitive

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[8] *E.g., Federal-State Joint Board on Universal Service; Access Charge Reform*, Seventh Report and Order and Thirteenth Order on Reconsideration, CC Docket No. 96-45, Fourth Report and Order, CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8078, 8082, 8099 (1999).

[9] *Id.*

[10] *Access Charge Reform Order* at 16012.

imbalance.

II. THE DIVERSE NATURE OF RATE OF RETURN CARRIERS MAKE A ONE SIZE FITS ALL APPROACH UNWORKABLE.

Rate of return carriers are those carriers who are not covered by price cap regulation. This group is comprised primarily of small to medium size LECs, and encompasses many of the carriers serving rural and insular areas of the United States. Rate of return carriers are a more diverse group than price cap LECs. Any access charge reform plan considered by the Commission must take this diversity into account.

A. Any Reduction in the Plan's Flexibility Will Decrease its Effectiveness.

In contrast to large price cap LECs, which typically have thousands of wire centers in hundreds of communities covering large regions of the country, a smaller rural or insular rate-of-return carrier has a much smaller opportunity to spread its investment across a range of diverse areas. Typically, these service areas are high-cost, low population areas, with no balancing low-cost regions such as large urban areas. As a result, such a carrier is more exposed to whatever unique business risks may be present in its smaller, more limited service areas.

Different rate-of-return carriers serve communities ranging from islands in the Atlantic ocean to isolated rural communities in the desert. While each of these areas presents challenges to the rate-of-return carriers that are distinct from those faced by larger, price cap LECs, there is obviously little about these challenges that are the same from carrier to carrier. Further, as the MAG plan recognizes, rate-of-return carriers vary in size from those serving only a few hundred people to those serving many thousands.[11]

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[11] *Petition* at ii.

It is imperative that any access reform the Commission adopts recognizes and acknowledges the variability among rate-of-return carriers, and provides a structure that accommodates this diversity. The MAG plan, as currently constituted, strikes a balance between the goals of reforming access charges and the diverse needs of rural carriers by building in a substantial number of options, including the ability to choose incentive or rate-of-return regulation and the option to stay in or leave the NECA pool, either altogether or only for traffic sensitive elements.[12] Affording rate-of-return carriers the opportunity to select for themselves the key features of their regulatory structure from a number of reasonable options, based on their own analysis of their unique situations, is central to the success of the MAG plan. Limiting opportunities for choice under the plan would substantially reduce the plan's effectiveness and undermine universal service.

At the very least, the FCC must not implement the plan without the current Path A and Path B options. These options are included in the MAG plan because the plan recognizes that not all rate-of-return carriers can reasonably operate under an incentive based regulatory model, even after access charges are reformed.[13] Some carriers have service areas that present so many challenges, such as isolation, harsh environmental factors, low population density, little or no population growth, and high infrastructure costs, that incentive regulation would simply be too unpredictable to be workable. Without traditional rate-of-return regulation, these carriers would be unable to attract capital on a reliable basis. Therefore, the option of selecting rate-of-return or incentive regulation must be retained in whatever plan the Commission adopts.

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[12] *Id.* at Exhibit 1 at 1-1, 1-2

[13] *Petition* at 6.

B. Insular Areas Experience Unique Challenges In Providing Telecommunications Service.

Carriers serving insular areas face circumstances that have the effect of driving up their costs of providing services to customers. These characteristics are directly tied to the unique nature of insular areas – their geographic isolation, their topography and geology, and the severe weather that they encounter.[14]

Geographic Isolation. A community located on an island suffers from much higher transport costs than a similar community located on the mainland. The amount of these costs increase rapidly the farther the island is from the mainland because of the increased distance that material must be transported either by sea or air. The impact of transport costs on an area like the Virgin Islands is substantial: A review of Innovative work orders indicates that every dollar of material used in operations incurs a transportation cost of $1.10, which more than doubles the effective cost of the equipment. In the event of an emergency, it is difficult or impossible to rely on rapid importation of spare parts or specialized personnel. As a result, insular telephone carriers must stock substantially higher numbers of spares than a rural telephone carrier on the mainland might.

An insular carrier must be prepared to compensate for failures in other areas of infrastructure, as well. Less reliable electricity translates into a need for greater redundancy in backup systems, as well as a need for a longer term operating capability for back-up systems. Both of these requirements increase costs.

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[14] The harsh impact of these factors on insular carriers has been explored in detail by Dr. Kenneth Gordon, Vice President of National Economic Research Associates, Inc. ("NERA") and former Chairman of the Massachusetts Department of Public Utilities and the Maine Public Utilities Commission. *See* Comments of Dr. Kenneth Gordon, CC Docket No. 96-45, *filed with Comments of Virgin Islands Telephone Co.* (filed Dec. 17, 1999).

Geography, Topography, and Weather While insular areas in tropical climates are frequently portrayed as a kind of paradise, the reality for telecommunications service is very different. Insular areas, such as the U.S. Virgin Islands, are often formed as the result of volcanic activity, which leads to rough, rugged terrain composed mainly of volcanic rock, with extreme elevation changes over very short distances. The warm, moist tropical climate leads to enhanced need for environmental protection for telecommunications equipment and infrastructure. Exacerbating this problem is the high level of airborne salt, which perpetually blows in from the surrounding ocean and causes rapid corrosion of plant.

Many insular areas also lie in the path of very severe weather patterns. The U.S. Virgin Islands are no exception. The territory's location in the Caribbean means that it is frequently hit by hurricanes,[15] which can rapidly and unexpectedly destroy large amounts of the Islands' infrastructure.[16] In fact, in 1999, the Islands suffered a direct hit from Hurricane Lenny, which caused very substantial damage on St. Croix. Hurricane Lenny is the fifth hurricane to smash into the islands in the past ten years. These severe weather conditions led the Commission's Rural Task Force to comment that: "Recent experience with hurricanes in the Virgin Islands seems to indicate that with the current frequency of these severe natural disasters, plant service lives may be better measured in months instead of years."[17]

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[15] NOAA has estimated that, in any given year, there is a greater than 50% probability that the U.S. Virgin Islands will be hit by a hurricane or tropical storm. *See* Christopher W. Landsea, *FAQ: Hurricanes, Typhoons and Tropical Cyclones, Part G: Tropical Cyclone Climatology*, *at* http://www.aoml.noaa.gov/hrd/tcfaq/tcfaqG.html#G12 (last modified Aug. 9, 2000).

[16] When Hurricane Marilyn hit the Virgin Islands in 1995, the Islands encountered maximum sustained winds of 102 mph, which destroyed an estimated 80% of the homes and businesses on St. Thomas and left at least 10,000 people homeless. *See* Edward N. Rappaport, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Marilyn*, *at* http://www.nhc.noaa.gov/ 1995marilyn.html (last updated Jan. 17, 1996). Approximately 30% of the houses on St. John were destroyed, and 20-30% of the houses on St. Croix were damaged. *See id.*

[17] Rural Task Force, *White Paper 2: The Rural Difference*, at 29 (Jan. 2000), *available at* http://www.wutc.wa.gov/rtf.

The telecommunications infrastructure in the U.S. Virgin Islands is especially vulnerable because the rocky makeup of the ground generally makes the use of underground or buried cable expensive. A large amount of resources must be devoted to repairing and rebuilding the communications network when it suffers damage from these storms, which happens with alarming frequency.[18]

III. TO BE TRULY EFFECTIVE, THE PLAN MUST INCLUDE A PROVISION TO ALLOW SMALL CARRIERS TO RECOVER THEIR REASONABLE EXPENSES IN THE EVENT OF CATASTROPHIC LOSS.

The MAG plan goes a long way to ensuring that all rate-of-return carriers will benefit from its adoption. The plan does have an important shortcoming, however, because it does not allow carriers adopting the incentive based regulation under Path A to adequately recover their costs in the event of a catastrophe, such as hurricanes or earthquakes. Without a mechanism to provide this cost recovery, the risk of Path A for some LECs will simply outweigh any potential benefits that they may gain from moving to incentive regulation. The FCC must address this shortcoming in order to make the incentive regulation portion of the MAG plan effective.

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[18] Only ten months after Hurricane Marilyn, the Virgin Islands were hit by Hurricane Bertha, which damaged almost 2500 homes on St. Thomas and St. John. *See* Miles B. Lawrence, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Bertha*, *at* http://www.nhc.noaa. gov/1996bertha.html (last updated Nov. 9, 1996). Two years later, Hurricane Georges caused an additional $50 million in damage to the Islands. *See* John L. Guiney, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Georges*, *at* http://www.nhc.noaa.gov/1998georges.html (last updated Jan. 5, 1999). The most recent event was Hurricane Lenny, a category 4 storm that slammed into St. Croix on November 16-17, 1999. Damages from this storm have been estimated at $165 million for Puerto Rico and the U.S. Virgin Islands. *See* John L. Guiney, Nat'l Hurricane Ctr., *Preliminary Report on Hurricane Lenny*, *at* http://www.nhc.noaa.gov/1999lenny.html (last modified Mar. 31, 2000).

A. The MAG Plan's Low End Adjustment is Inadequate to Provide Recovery in the Event of Disaster.

The Low End Adjustment (LEAF) feature of the MAG plan allows a pooled carrier who elects Path A incentive regulation to apply for an adjustment at the end of a tariff period if its study area interstate access rate of return for that period drops a certain amount below a specified level.[19] The triggering level depends on whether the carrier has fewer or more than five study areas subject to incentive regulation.[20] However, the LEAF, as currently envisioned, would only provide an adjustment to a 10.75% rate of return in the case of small carriers, and a 10.25% rate of return in the case of larger carriers.

The LEAF would help provide some level of protection for a carrier who is unable to achieve a specified rate-of-return under incentive regulation. However, it is not a sufficient safeguard for carriers located in high-risk areas, such as island regions. As demonstrated above, insular carriers face a phenomenal risk of having their facilities destroyed in weather-related disasters.[21] While insurance can cover certain costs associated with storm damage and business interruption, small carriers also need a mechanism to quickly adjust rates in response to investment and expense necessitated by restoration of service. By capping the amount of the LEAF below the nominal 11.25% rate-of-return, the MAG plan would guarantee that carriers electing incentive regulation would be prevented from fully recovering their costs in the event of a catastrophic destruction of their infrastructure. This undermines universal service in

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[19] *Petition* Exhibit 1 at 1-11, 1-12.

[20] For carriers with fewer than five study areas subject to incentive regulation, the rate-of-return must drop 0.5% below 11.25%. For carriers with more than five study areas subject to incentive regulation, the rate-of-return must drop 1% below 11.25%. *Id.*

[21] See Section II B.

circumstances where government policy should ensure a speedy and complete recovery from the disaster.

B. The FCC Must Address Cost Recovery in the Event of Catastrophic Loss.

For carriers located in areas such as the U.S. Virgin Islands, where there is a higher than 50 percent chance of being hit by a dangerous storm in any given year and where "plant service lives may be better measured in months instead of years,"[22] the inability to recover the costs associated with catastrophic loss is untenable. Any potential rewards from incentive regulation may thus be overwhelmed by the inability of the carrier to recover its costs of rebuilding after a devastating storm. In the U.S. Virgin Islands, such storms are not risks, but rather near certainties.

In order for the MAG plan to truly be successful in encouraging carriers to move to incentive regulation, it must offer a way for carriers in high-risk areas to elect to pursue incentive regulation while ensuring that they have a method for recovering their costs in the event of loss. Eliminating the 10.25%/10.75% caps on the LEAF in the event of catastrophic loss, and allowing carriers to recover their normal rate-of-return in these circumstances, would provide a simple and effective method to address this problem.

IV. THE FCC SHOULD ELIMINATE REQUIREMENTS THAT DISCOURAGE SMALL CARRIERS FROM ACQUIRING AND UPGRADING TELEPHONE EXCHANGES.

Public policy considerations and the requirements of Section 254 support the modification of rules limiting the universal service support a carrier can receive on lines it obtains through mergers and other types of acquisitions. The limitation, adopted as a "stopgap

[22] Note 15, 17, *supra*.

measure" to address a specific problem at a particular point in time,[23] today arbitrarily prevents carriers from obtaining adequate support. "[B]y freezing support based on the seller's embedded costs, the rule prevents the acquiring carrier from receiving an amount of support related to the costs of providing supported services in the transferred exchange."[24] The policy not only leaves acquiring carriers with inadequate support, but limits their ability to invest in higher quality and advanced services in that service territory.

The FCC's merger and acquisition cap on universal service funds also jeopardizes the requirements of Section 254. All Americans, including those in rural and insular areas, should enjoy "[q]uality services"[25] and "have access to...advanced telecommunications" and information services.[26] The Commission recognizes that a significant public interest benefit to the transfer of rural exchanges is that the new company is willing to make new investment in the old facilities in order to provide advanced services.[27] As noted by the Rural Task Force in the Universal Service proceedings, however, Section 54.305 of the Commission's Rules "limits the ability and motivation of the acquiring entity to make new investments to upgrade the networks" of acquired properties.[28] Under the existing approach, customers in high cost rural exchanges involved in transfers are "'doomed' to poor service."[29] In short, such a policy is shortsighted and

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[23] *Federal-State Joint Board on Universal Service*, 15 FCC Rcd 14714, 14723 (June 30, 2000) (Recommended Decision).

[24] *Id.*, 14724.

[25] 47 U.S.C. § 254(b)(1).

[26] *Id.* § 254(b)(6).

[27] *See Puerto Rico Telephone Authority, Transferor, and GTE Holdings (Puerto Rico) LLC, Transferee, for Consent to Transfer Control of Licenses and Authorization Held by Puerto Rico Telephone Company and Celulares Telefonica, Inc.*, 14 FCC Rcd 3122 (1999).

[28] *Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 at 29 (Sept. 29, 2000).

[29] *Id.*

not in the overall public interest. The Commission should adopt an approach that encourages investment in newly acquired exchanges, as supported by the clear language of Section 254.

The MAG plan recognizes the need to reform existing universal service rules to avoid discouraging small carriers from acquiring and upgrading exchanges. Thus, the plan calls for the elimination of Section 54.305.[30] Innovative urges the Commission to adopt a universal service policy that allows for full universal service support notwithstanding whether the exchanges were acquired from another carrier that required less support due to study area-wide averaging.

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[30] We note that the Rural Task Force also proposed a somewhat different solution to rectify the negative policy implications of existing policy. Innovative supported the RTF recommendation as a reasonable compromise, even though complete elimination of the rule would provide more complete universal service support.

V. CONCLUSION

For the forgoing reasons, the Commission should adopt the MAG plan as proposed, with the addition of an adequate means for ensuring recovery of costs in the event of catastrophic loss, such as a change in the cap on the LEAF from 10.25% or 10.75% to 11.25% in these circumstances.

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