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

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| 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 |

**REPLY COMMENTS OF GVNW CONSULTING, INC.**

GVNW Consulting, Inc. respectfully submits these reply comments in response to the Commission's Notice of Proposed Rulemaking (NPRM) in the above-referenced dockets. The focus of the Commission's instant Notice is the Petition for Rulemaking submitted October 20, 2000 by the Multi-Association Group (MAG). 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 the United States Telecom Association (USTA). This MAG petition offers an interstate access reform and universal service support proposal applicable to incumbent local exchange carriers subject to rate-of-return regulation, and requests a five-year implementation period to commence on July 1, 2001.

GVNW Consulting is a management-consulting firm that provides a wide variety of consulting services, including regulatory support on issues such as universal service and access reform for communications carriers in rural America. Many of the carriers represented by GVNW serve high-cost, rural areas of the country.

The MAG petition received considerable criticism in the comments filed with the Commission on February 26. For instance, the Regulatory Commission of Alaska stated that the plan would require considerable modification. The Association of Communications Enterprises ("ASCENT") alleges the MAG plan "appears to have been designed principally to insulate the participating incumbent LECs from adverse market forces; indeed, it provides these carriers with a veritable windfall" (ASCENT, 2). The California PUC attacks the petition' lack of a productivity offset that would ensure that a portion of efficiency gains would flow to customers in the form of reduced rates and/or reduced universal service funding. Based on a review of these and other comments filed, we are concerned that the Commission may be tempted to "pick and choose" from some of the narrowly-focused advocacy positions found within the comment filings, without regard to the substantive operational and geographical differences that exist among the rural, rate-of-return subset of carriers. We urge the Commission to retain the "Path B" option for carriers to remain on rate-of-return regulation. Reply comments on this issue of optionality and replies addressing other key rural carrier issues are as follows. Specific references to the comments of the filing parties are noted by parenthetical reference to the party name and page numbers, where appropriate.

## THE CHOICE OF PATH A AND PATH B FOR RURAL CARRIERS IS DICTATED BY THE VAST DIFFERENCES WITHIN THE RURAL CARRIER SUBSET

The MAG petition proposed two choices or "paths" for rate of return carriers. Path A is the choice for carriers desiring incentive regulation, with Path B the option for carriers desiring to continue with rate of return regulation. In its comments, the Public Service Commission of Wisconsin (Wisconsin PSC) asked the question in its footnote 4:

"…it is not clear in the MAG proposal what the need is for a Path A and Path B and nonpooling option in Path A, especially when the proposal includes the availability of a low-end adjustment."

The purpose of this first section of these reply comments is to demonstrate why there is a need for a choice of paths for rate of return carriers. Rural rate of return companies exhibit significant variations in both study area size and customer base. The Rural Task Force (RTF) via its White Paper 2, entitled <u>The Rural Difference</u>, released in January 2000, has placed the nature and scope of these significant differences within the subset of rural carriers in the public record. The White Paper offered a very detailed analysis of the major rural carrier differences, which we summarized in our comments filed on February 26. In reviewing the comments filed in this MAG proceeding, we believe that certain parties may not have had an opportunity to review, or have chosen to ignore, the data presented by the RTF in its second white paper and summarized in its recommendations. Therefore, we reiterate the RTF's nine conclusions below, and offer excerpts from the supporting detail that substantiated the RTF's exhaustive, empirical analysis of the rural difference.

1) Rural carriers serve more sparsely populated areas. The average population density is only 13 persons per square mile for areas served by rural carriers

compared with 105 persons per square mile in areas served by non-rural carriers.

2) There is significant variation in study area sizes and customer bases among rural carriers. The average population density of areas served by rural carriers varies dramatically. Rural carriers in Alaska and Wyoming serve populations of 0.58 and 1.25 persons per square mile respectively, while rural carriers in some states serve populations of over 100 persons per square mile.

3) The isolation of areas served by rural carriers results in numerous operational challenges. Rural carriers experience difficulty and high cost in moving personnel, equipment and supplies to remote and insular communities. More resources, including duplicate facilities and backup equipment are required to protect network reliability.

4) Compared to non-rural carriers, the customer base of rural carriers generally includes fewer high-volume users, depriving rural carriers of economies of scale. Non-rural carrier study areas typically have higher business customer density than rural carrier study areas.

5) Compared to customers of non-rural carriers, customers of rural carriers tend to have a relatively small local calling scope and make proportionately more toll calls. Seventy to eighty percent of customers of smaller rural carriers can reach less than 5,000 other customers with a local call.

6) Rural carriers frequently have substantially fewer lines per switch than do non-rural carriers, providing fewer customers over which to spread high fixed

network costs. On average, rural carriers have only 1,254 customers per switch compared to over 7,000 customers per switch for non-rural carriers.

7) Total investment in plant per loop is substantially higher for rural carriers than for non-rural carriers. On average, total plant investment per loop is over $5,000 for rural carriers compared to less than $3,000 for non-rural carriers.

8) Plant specific and operations expenses for rural carriers tend to be substantially higher than for non-rural carriers. On average, plant specific expenses per loop are $180 for rural carriers compared to $97 per loop for non-rural carriers.

9) Customers served by rural carriers have different demographic characteristics from customers in areas served by non-rural carriers. Native Americans are disproportionately represented among those without phone service. Rural carriers serve a higher percentage of Native American customers than non-rural carriers.

Optionality, in various forms, has existed for decades

While the Telecommunications Act of 1996 granted both competitive opportunity and assigned certain universal service responsibility, it does not eliminate the choices that currently exist, but rather continues to recognize small carriers differences. Carriers are provided, as a matter of prudent public policy, a variety of options at present. Local exchange carriers choose between average schedule and cost-based interstate settlement mechanisms, pooling versus individual company tariff filings, and are offered choices within the intrastate regulatory arena. A large part of the reason that universal service has been achieved in rural America in the last two to three decades is due to the panoply of options available to meet the myriad of customer needs and concomitant company challenges in the hard to serve areas of rural America.

Several parties correctly identify the elective benefits of the MAG proposal. For example, the Alabama Rural LECs state that the MAG plans' elective structure of Path A and Path B avoids a "one size fits all" mechanism that fails to accommodate differences. Additional support comes from a group of Arizona companies: "…the regulation plan takes into consideration the diversity of the small and mid-sized rural telephone companies while at the same time preserving rate of return regulation for those companies that need it." (Arizona Local Exchange Carrier Association, 2)

As stated by the Western Alliance (Western Alliance, ii):

> "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 fluctuations in operating expenses."

At least two options are a necessary component of a reasoned public policy approach geared to meet **rural** universal service needs. The optionality in the MAG petition must be retained.

DISAGGREGATION OF UNIVERSAL SERVICE SUPPORT IS NECESSITATED BY THE ACT'S PORTABILITY REQUIREMENT

In the comments of the Ad Hoc Telecommunications Users Committee (Ad Hoc), Ad Hoc was only partially correct when they allege:

> "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."** (Ad Hoc, ii – iii) (Emphasis added)

The Competitive Universal Service Coalition (CUSC) voiced similar concerns (CUSC, ii). The propensity to "game" the federal universal service support system falls not with the incumbent LEC, but rather some portion of the new competitive entrants group. Disaggregation of federal universal service support is necessitated by the "gaming" that is likely to occur from providers whose business plans are predicated on "cherry picking" customers from providers of last resort.

Competitive carriers seek portability in terms of the ILEC's cost of service. Equity dictates that a system be employed that, subject to constraints of administrative workability, the costs that are portable most closely match those related to serving the actual customer gained by the competitive entrant. Common sense tells us that it is not practical, or even possible in some instances, to devise a support portability system that tracks customer costs on an individual location basis. However, disaggregation zones may be developed that serve as a surrogate for individual customer costs. **Disaggregation of federal universal service support below the wire center level is the *quid pro quo* to portable federal universal service support.**

Many parties (e.g., Alaska Rural Coalition, Regulatory Commission of Alaska, Evans Tel et al) recognize the need for disaggregated support in a regulatory paradigm that requires portable support. Century Tel is correct when they commented that reform is critically needed since support that is averaged across an entire study area fails to provide sufficient support to a rural carrier's highest cost lines.

## LOW END ADJUSTMENT FACTORS SHOULD NOT BE THE EXCLUSIVE DEVICE OF PRICE CAP CARRIERS

The MAG petition proposed a low-end adjustment factor (LEAF) for carriers choosing Path A incentive regulation. The purpose of the LEAF is to provide an earnings backstop for carriers selecting Path A. This proposed mechanism is similar to the mechanism that has been put in place by the Commission for carriers subject to price cap regulation. Some parties, such as the California PUC, are opposed to the low-end adjustment "that would protect a carrier from almost all risk".[1]

Other parties support the Commission extending the same treatment to small and mid-size carriers choosing an incentive regulatory option that is available to the nation's largest telephone providers. The Western Alliance offers support for the LEAF by stating that the low-end mechanism:

> "…is essential for the preservation of 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." (Western Alliance, iii)

The Interstate Telecom Group echoes the Western Alliance assertions in its filing: "The low-end adjustment constitutes a safety net that is essential for the investment capability and operating viability of Path A LECs".

Innovative Telephone (formerly Virgin Islands Telephone) recommends that the LEAF be modified to allow carriers to recover up to the authorized 11.25% rate of return in the event of a catastrophic loss. As proposed, the MAG LEAF provision sets the low-end backstop at 10.75% for carriers with 5 or fewer study areas, and 10.25% for carriers with more than five study areas.

[1] We find it somewhat perplexing that given the current state of the energy industry in California, the California PUC would be critical of provisions of a plan that protects carriers from risk in a capital-intensive industry.

NO PARTIES HAVE OFFERED PERSUASIVE COMMENTS IN THIS INSTANT NPRM TO REDUCE THE AUTHORIZED INTERSTATE RATE OF RETURN

We are pleased to note the broad array of support for retaining the current interstate rate of return.

In fact, Qwest indicated in their filing that the rate-of-return docket (CC Docket No. 98-166) should be closed leaving interstate ROR at 11.25%.

The Arizona Local Exchange Carriers Association offers the opinion:

> "In today's slowing economy, the Commission's current authorized rate of return reflects the minimum realistic cost of capital. To alter that rate of return would create serious investment disincentives …" (Arizona LECA, 2-3)

A number of parties filed supporting comments that stated that the current interstate rate of return (11.25%) should be retained. (e.g., Alabama Rural LECs, Alaska Telephone Association, Interstate Telecom Group, Rate of Return Coalition)

While GVNW believes that the prior record in CC Docket No. 98-166 supports an increase, we believe that the retention of the current interstate rate of return of 11.25% is a reasonable compromise.

CONCLUSION

Comparing small LECs to small price cap companies is an invalid comparison and ignores the large body of empirical evidence that has been placed in the record in the CC Docket No. 96-45 proceeding. Without the path proposed in the MAG petition allowing companies to remain on rate of return regulation (Path B), the MAG incentive plan (Path A) will simply not work as a regulatory mechanism for each and every rural non price cap carrier.

Respectfully submitted,

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