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

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In the Matter of	)	
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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

PETITION FOR RECONSIDERATION

OF THE

ALLIANCE OF INDEPENDENT RURAL TELEPHONE COMPANIES

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SUMMARY

AN ACT To promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.

The Alliance of Independent Rural Telephone Companies ("Alliance") seeks reconsideration of aspects of the Commission's *MAG Order* that are in conflict with the policy objectives of the Communications Act of 1934, as amended. The Act seeks reductions in rates paid by consumers; but, the *MAG Order* produces increases in rural consumers' telephone service bills without providing any tangible consumer benefits. The Act seeks to encourage carrier investment in higher quality services and advanced technologies; but, the *MAG Order* results in an unstable environment for rural rate-of-return carriers and, thereby, discourages investment.

In order to rectify this result, the Alliance maintains that the Commission should reconsider and rescind the adoption of rule modifications regarding three specific *MAG Order* determinations:

(1) the *MAG Order* improperly requires that all non-traffic sensitive ("NTS") carrier common line ("CCL") costs must be recovered from either end user charges or a new form of universal service support mechanism;

(2) the *MAG Order* improperly requires that subscriber line charge ("SLC") caps for rate-of-return carriers should be increased to the levels established for price-cap carriers; and

(3) the *MAG Order* improperly requires that rural rate-of-return LECs are required to recover universal service contributions only through end user charges.

In the absence of the requested reconsideration, the *MAG Order* will modify the Commission's rules in a manner that departs from established law, public policy and Commission practice. In reconsidering these issues, the Alliance respectfully suggests that the Commission should be guided by three fundamental policy principles:

(1) a rural rate-of-return LEC should be permitted to establish rates for interstate access services that recover its interstate access costs;

(2) rural customers should not pay rates that unreasonably support services provided to other customers; and

(3) rates for services should reflect a carrier's costs in order to provide appropriate market signals that enable prospective entrants to assess whether to enter a particular market.

Although the *MAG Order* acknowledges these principles, the order adopts policy and rule changes that are inconsistent.

The results of the *MAG Order* appear driven toward a predetermined agenda – reductions in rural carrier access charges without regard for the specific characteristics and needs of rural consumers and rural carriers. While the *MAG* proceeding was initiated to consider a specific rural carrier association consensus proposal for rural access structures and universal service, the *MAG Order* rejected the proposal and adopted rule modifications in the absence of opportunity for comment or consideration and development of alternative rate design structures that would work in concert with the objectives of the Act.

In the absence of the requested reconsideration, the *MAG Order* is contrary to the statutory and policy goals of securing lower prices for consumers, securing higher quality services, and encouraging the rapid deployment of new telecommunications technologies.

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PETITION FOR RECONSIDERATION

AN ACT To promote competition and reduce regulation <u>in order to secure lower prices and higher quality services</u> for American telecommunications <u>consumers</u> and <u>encourage</u> the rapid deployment of new telecommunications technologies.[1]

The Alliance of Independent Rural Telephone Companies ("Alliance")[2] respectfully files this Petition for Reconsideration of certain provisions of the Commission's *Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166* ("*MAG Order*") released in the above-captioned proceeding on November 8, 2001. The Alliance

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[1] Preamble to the Telecommunications Act of 1996 (underscoring added as emphasis).

[2] The Alliance is an *ad hoc* coalition of over 200 rural incumbent local exchange carriers ("LECs") that was formed subsequent to the filing of the initial comments on February 26, 2001, in both this proceeding and the proceeding that resulted in the Commission's Order released on May 23, 2001 in CC Docket Nos. 96-45 and 00-256, 16 FCC Rcd 11244 (referred to herein as the *Rural Task Force Order)*. Accordingly, and in accordance with § 1.429(a) of the Commission's Rules, the Alliance and its members are interested persons with respect to this proceeding.

seeks reconsideration of specific aspects of the *MAG Order* that are in conflict with the Communications Act of 1934 (the "Act"), as amended, including the Telecommunications Act of 1996 ("1996 Act"). Moreover, those aspects of the *MAG Order* for which reconsideration is sought involve rule changes that have been made in the absence of factual and legal support and also result in a new set of regulations that are contrary to the very policies the Commission espouses throughout the *MAG Order*.

I. The Alliance Seeks Reconsideration of Three Specific Aspects of the *MAG Order* that Conflict with Statutory Requirements, Lawful Commission Policy and the Public Interest.

The Commission has recognized since the passage of the 1996 Act, and the Courts have affirmed, that there is a difficult balance that must be maintained in steering a new course in regulation that both promotes competition and concurrently maintains and fosters universal service objectives. In steering that course, the Commission appropriately recognized that the need for consideration of changes in both the existing access charge and universal service rules presented "interrelated issues without a single, precise solution."[3] Accordingly, the Commission also recognized the need for separate review of the issues and circumstances specific to rural telephone companies and rate-of-return carriers.[4]

The Commission initiated this proceeding almost one year ago in order to consider a comprehensive consensus proposal presented on behalf of incumbent rural telephone companies by a group of four industry associations (referred to as the Multi-Association Group or "MAG"). The Commission acknowledged "the significant achievement" represented by the development of

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[3] *MAG Order* at para. 5 citing the *Interstate Access Support Order*, 15 FCC Rcd 12962, 12978 at para. 38) (2000).

[4] *Id.* The Commission correctly recognizes that all but a very few of the rate-of-return carriers are also rural telephone companies, as are all members of the Alliance.

a plan of consensus among the rate-of-return carriers.[5] As the Commission is aware, individual rate-of-return carriers supported MAG only in its entirety and only as a consensus plan. Numerous carriers filed comments to this effect and asked that the Commission afford additional and meaningful opportunity for the consideration of alternative proposals for changes in access structure in the event that the MAG plan was not adopted as a whole.[6]

While the *MAG Order* adopts aspects of the MAG proposal, it represents essentially the rejection of MAG and the adoption of rule changes that are aimed at a class of carriers that have not been afforded a meaningful opportunity to comment on the very rules that were adopted.[7] The *MAG Order* professes that it is "tailored to the needs of small and mid-sized local telephone companies serving rural and high-cost areas, and will help provide certainty for rate-of-return carriers, encourage investment in rural America, and provide important consumer benefits."[8] The facts are, however, that certain aspects of the order create uncertainty for rate-of return carriers, discourage investment in rural America, and increase consumer rates.

A. The Preamble to the Telecommunications Act of 1996 establishes the minimum benchmark that the Commission's actions must meet. The aspects of the *MAG Order* that warrant reconsideration do not meet this benchmark.

The Commission begins the *MAG Order* with the conclusive, but incorrect, presumption

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[5] *See, MAG Order* at paras. 7-8.

[6] *See, e.g.*, Alliance Reply Comments in this proceeding, pp. 3-4.

[7] For example, the *MAG Order* implements a new form of universal support mechanism in the absence of a meaningful opportunity for parties to consider and respond to the adopted proposal. The order also addresses the mechanism by which a LEC may recover its universal service expense, again without any opportunity for comment and consideration by the carriers that are impacted. Accordingly, the *MAG Order* fails to recognize the diversity in rate-of-return LECs that was reflected in the actual proposal of the MAG, and the process failed to provide a second round of public comment -- a supplemental round that, in contrast, was afforded the much larger price-cap LECs in the context of their CALLS proposal -- to examine and set forth positions on potential modifications, particularly those changes inconsistent with the underlying principles of the MAG proposal.

[8] *MAG Order* at para. 3.

that the order modifies the Commission's Rules in a manner that is "consistent with the Telecommunications Act of 1996."[9] This presumption is unwarranted. The Alliance has set forth above the very words that constitute the preamble to the Telecommunications Act of 1996 with underscoring to emphasize the intent of the statute. Too often, both within and outside of the context of the *MAG Order*, members of the Alliance have observed an institutional tendency by the Commission to consider fully only whether its actions may be deemed "to promote competition," as though competition were a goal in itself, rather than a potential means to an end.

The preamble to the 1996 Act, however, makes clear that the promotion of competition alone is not an objective. As established by the 1996 Act and reflected specifically by the preamble, the statute provided the tools to promote competition and reduce regulation in order to achieve specific goals: ***to secure lower prices and higher quality services*** *for American telecommunications* ***consumers*** *and* ***encourage*** *the rapid deployment of new telecommunications technologies*. The adoption of modifications to the Commission's rules are not "consistent with the Telecommunications Act of 1996" if those rules merely promote competition. The appropriateness of the rules must be judged with respect to whether they meet the statutory threshold established by the 1996 Act:

1. Will the Commission's actions secure lower prices for consumers?

2. Will the Commission's actions secure higher quality services for American consumers?

3. Will the Commission's actions encourage the rapid deployment of new telecommunications technologies?

The Alliance respectfully submits that the answer to each of these threshold questions is a

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[9] *MAG Order* at para. 1.

resounding "NO" with respect to three specific actions adopted in the *MAG Order*:

1. The determination that all non-traffic sensitive ("NTS") carrier common line ("CCL") costs must be recovered from either end user charges or a new form of universal service support mechanism called Interstate Common Line Support ("ICLS");[10]

2. The determination that the Subscriber Line Charge ("SLC") caps for rate-of-return carriers should be increased to the levels established for price-cap carriers;[11] and

3. The determination that rural rate-of-return LECs are required to recover universal service contributions only through end user charges.[12]

Individually and collectively, these actions will immediately increase prices for America's rural consumers and discourage the rapid deployment of advanced technologies in rural America. Accordingly, the Alliance respectfully requests that the Commission rescind each of the rule modifications adopted by the *MAG Order* to effectuate these actions, and that the Commission issue a Further Notice to consider: 1) appropriate changes in rural LEC interstate access rate structures; 2) whether and to what extent changes in rural LEC SLCs may be appropriate; and 3) the appropriate structure for rural LECs to recover their universal service contributions.

B. The Commission's overall intent to establish rules and policy that will serve the interests of rural subscribers has been undermined by reliance on incorrect legal interpretation and policy assumptions.

The Alliance is aware and appreciative of the fact that the Commission has approached consideration of changes in access charge structure and universal service support mechanisms with an articulated understanding of the need for policies that reflect the very real operational and

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[10] *See, e.g.*, 47 CFR §§ 54.307, 54.315, 54.701-702, 54.705, 54.715, 54.901-904, 69.2, 69.4, 69.105, 69.130, 69.306, 69.501-502.

[11] *See, e.g.*, 47 CFR §§69.104-105.

[12] *See* 47 CFR § 69.131.

market distinctions that exist between rural and non-rural companies.[13] Each of the determinations in the *MAG Order* for which the Alliance seeks reconsideration, however, disregards these very distinctions between rural and non-rural (and rate-of-return and price cap) LECs. These matters for reconsideration are in stark contrast to other aspects of the *MAG Order* specifically and the Commission's policies in general, where these distinctions have not only been recognized, but have been the basis for the Commission's thoughtful adoption of policy affecting rural subscribers and their rural incumbent providers.[14]

1. The *MAG Order* deviates from the rational policy framework established by the Commission for consideration of rural LEC access charge structures.

Within the discussion set forth throughout the *MAG Order*, the Commission notes with affirmation three basic policies regarding rural LECs and their subscribers that the Alliance agrees should be at the foundation of the Commission's policies. The *MAG Order*, however, proceeds to ignore these basic principles while adopting those actions for which the Alliance seeks reconsideration. The basic policy principles which the Commission articulates in the *MAG Order*, and should maintain, are as follows:

A rural LEC should be permitted to establish rates for its interstate access services that recover its costs.[15]

Almost within the same metaphorical breath that the Commission affirms this principle,

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[13] Rural companies "generally have higher operating and equipment costs than price cap carriers due to lower subscriber density, smaller exchanges, and limited economies of scale." *MAG Order* at para. 4. The Courts have also acknowledged the rural/non-rural telephone company distinction that exists as a result of both operational and market facts, and is codified in the 1996 Act (§§ 214(e), 251, and 254). *See, e.g., Alenco Communications, Inc. v. FCC*, 201 F.3d 608 (5th Cir. 2000)("*Alenco*") and *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001) ("*Qwest*").

[14] *See, e.g., Rural Task Force Order*, 16 FCC Rcd 11244 (released May 23, 2001). *See, infra*, Sec. II.

[15] *See, e.g., MAG Order* at paras. 12, 84 and 206.

the *MAG Order* concludes that a rural LEC serving high cost areas may recover a significant portion of its costs only from a new universal service support mechanism, the ICLS, instead of from rates assessed for the services it provides.

Customers should not pay rates that unreasonably support services provided to other customers.[16]

Irrespective of this principle, however, the *MAG Order* concludes that in rural LEC service areas, none of the NTS CCL costs should be recovered from any customer other than the end user, disregarding the fact that other customers benefit from the availability of the rural loop because they can call and be called by the end user. As discussed in Sec. II A, below, the fundamental deficiency of the *MAG Order* arises as a result of the disregard of established and existing principles of rational rate design for rural LEC rate-of-return carriers. The *MAG Order* ignores these principles and confuses rate design concerns with the identification of "implicit subsidy."[17]

"Rates that reflect an individual carrier's cost of service provide the proper signals to permit a potential entrant to decide whether to enter a particular market."[18]

While the Commission has repeatedly expressed concern about the sizing of universal support mechanisms and the potential for "gaming" associated with the provision of portable universal service support, the *MAG Order* arbitrarily labels a significant amount of the interstate costs incurred by rural LECs as "implicit subsidy," and provides for the recovery of these costs

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[16] *See, e.g., MAG Order* at paras. 18, 23, and 43. The discussions cited address concern about "subsidization" between high volume toll users and low volume toll users. The *MAG Order* does not address or recognize that it creates subsidization of urban interstate toll users by the rural end user subscribers. As discussed *infra* at Sec. II C.2. of this Petition, this outcome is contrary to existing law, rules, and practice.

[17] *See,* Section II.C., *infra.*

[18] *MAG Order* at para. 84.

through a new universal service support mechanism, the ICLS.[19] This determination was made without consideration of alternative rate designs that could be implemented to reflect a rural LEC's costs and thereby both provide proper market signals and avoid distortions caused by unnecessarily inflated universal service mechanisms.[20]

2. The divergence of the *MAG Order* from articulated policy objectives resulted from reliance on inaccurate legal conclusions and insufficient consideration of the characteristics of rural LEC service areas.

The Alliance has attempted to determine how and why the Commission may have been directed to the determinations within the *MAG Order* that depart from Commission policy objectives for the higher cost to serve rural areas and subscribers served by the rural telephone companies. The Alliance respectfully submits that the *MAG Order* is artificially supported by three basic premises that are presented as unquestioned absolute truths. Each of these premises, however is inaccurate with respect to its applicability to rural rate-of-return incumbent LECs and their subscribers:

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[19] *See, e.g., MAG Order* at paras. 89, 103, and 118, and *see generally, Rural Task Force Order*, 16 FCC Rcd 11244.

[20] The Alliance recognizes that the issue of "portability," as established by 47 CFR §§ 54.307, is not formally at issue in this proceeding. The *MAG Order* determination to impose increased rural LEC dependency on universal service support (and the concomitant prohibition on a rural LEC's opportunity to establish rates to recover its interstate costs) further exacerbates an already existing problem with respect to the "portability" (*i.e.*, equal availability to other carriers) of a rural LEC's level of cost recovery. The competitively neutral "portability" of a subsidy to a customer (*e.g.*, lifeline support) is far different from the portability (equal availability) of "support payments" that recover allocated interstate costs. However, many of the Commission's rules and practices have failed to recognize this distinction. As a result, the very "gaming" of the system with which the Commission is concerned has become increasingly prolific. While the Commission has often articulated its concern that incumbent rural LECs may "game" the support system, the Commission has not focused any attention on the "gaming" by non-incumbent rural LECs. Facts related to this issue are already before the Commission through various mechanisms and proceedings. For example, the Commission's required public report from the universal service administrator indicates the existence of inordinate universal service fund distributions that, while unrelated to any universal service objective, constitute apparent "lawful" gaming within the Commission's rules. The Alliance respectfully urges the Commission to open a formal inquiry into the distribution of universal service support to non-incumbent carriers in areas served by rural LECs for the purpose of determining appropriate modifications to its existing rules.

The *MAG Order* incorrectly assumes that all NTS costs recovered from access charges represents an implicit subsidy.[21]

On the basis of this incorrect premise, the *MAG Order* reclassifies interstate access costs as NTS[22] and improperly provides for recovery of those costs in excess of the SLC from a new universal service element, the ICLS.

The *MAG Order* incorrectly assumes that reductions in access charges assessed by rural LECs are necessary to achieve the statutory mandate that long distance carriers offer the same rates to customers irrespective of whether the customer resides in an urban or rural area.[23]

On the basis of this incorrect premise, the *MAG Order* wrongly concludes that it is appropriate to reduce rural LEC interstate access charges by both increasing SLCs and requiring the recovery of all residual common line costs from the ICLS (thereby reducing the access charge revenue requirement and creating a larger universal service fund).

The *MAG Order* incorrectly assumes that the concept of comparability of rates set forth in §254(b)(3) of the 1996 Act justifies increases in rural telephone company subscriber SLCs to the same level as price-cap company customer SLCs.

On the basis of this incorrect premise, the *MAG Order* will raise rural LEC subscriber SLCs without consideration of consumer impact or whether there is meaningful comparability.[24]

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[21] *See, e.g., MAG Order* at para. 41.

[22] This Petition does not challenge the Commission's right to determine the appropriate rate design for the recovery of interstate costs. The Alliance does, however, challenge the *MAG Order* determination that all NTS costs should be recovered from the end user; that the recovery of any NTS costs from an access charge constitutes "implicit subsidy;" and that it is permissible for the Commission to direct a rural LEC to recover costs from a portable support mechanism in lieu of permitting the carrier to establish rational rates for the services it provides.

[23] *See*, 1996 Act §254 (g). The *MAG Order* adopts an unsupported assumption that there is a need for reduced access charges in rural LEC areas as a necessary means to achieve geographically average long distance rates. *See, e.g., MAG Order* at paras. 6, 29, 64, 80, 87-88.

[24] *See, e.g., MAG Order* at paras. 43-44. The Alliance is well aware that the Commission did not literally "mandate" an increase in the rural subscriber SLC, but "merely" raised the cap on that which the carrier can assess. Many Alliance members are also aware that Commission staff is reported to have sternly warned rural LECs that they may not attribute the increase in the customer's bill to the actions of

(continued...)

The *MAG Order* reflects an unchallenged acceptance of each of these premises in the absence of either legal or factual support. As discussed in Section II. below, each premise is unfounded with respect to rural telephone companies and their customers. and reconsideration of the *MAG Order* decisions based on this faulty foundation is not only warranted. but required.

II. In the Absence of Reconsideration, the *MAG Order* will Result in Higher Prices Paid by Rural Consumers and Discourage Rural LECs from Investing in the Rapid Deployment of Advanced Technologies.

The Alliance recognizes the deference paid by the Courts. in general, to the Commission's expertise where discretion is required in the absence of a clear statutory directive.[25] In this regard. the Alliance is fully aware of those circumstances where the Courts have deferred to Commission discretion when the Commission was required to balance the objectives of the 1996 Act. Although the Commission's expertise warrants deference under those circumstances, it has also been held, however. that "the FCC may exercise its discretion to balance the principles against one another when they conflict. but may not depart from them altogether to achieve some other goal."[26]

This proceeding was initiated in the context of an identified need to focus on the specific characteristics of rural LEC rate-of-return carriers. However. the *MAG Order* is devoid of any consideration and application of those characteristics in the determinations related to increasing

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[24](...continued)
the Commission. The fact is, however, that the notion of whether the Commission "mandated" or merely "permitted" an increase is irrelevant to reality. In the absence of increasing the SLC, the *MAG Order* does not permit the rural LEC any other means of recovering the allocated interstate costs that it is "permitted" to recover from the SLC. The Commission has mandated that rural carriers may not recover these common line costs from any source other than the SLC. Without raising the SLC and recovering its costs of operations, the carrier cannot stay in business. No crafty or clever reading of the *MAG Order* alters the fact that the result of the Commission's decision is an increase to the prices paid by consumers.

[25] *See, e.g., Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837, 842-44 (1984) ; *see also Alenco.*

[26] *Qwest,* Slip Opinion at 16.

rural consumer end user fees and in its denial of an opportunity for rural LECs to establish rates for services to recover interstate access costs (and, instead, arbitrarily transferring the recovery of costs to a new universal service mechanism). With disregard for both the development of a factual record and an opportunity for consideration of alternatives to the adopted modifications, the *MAG Order* departs from statutory principles and existing policy under a cloak of "discretion" in order to support an apparent **single goal: reductions in rural LEC access charges.**

Clearly, and unfortunately, the *MAG Order* accomplishes nothing more than this apparent agenda. And it does so without regard to the ostensible framework of the proceeding -- the consideration of the specific characteristics of rate-of-return rural LECs and the resulting impact on their subscribers. Instead of advancing the goals of the 1996 Act -- promoting Universal Service, reducing consumer rates, and ensuring benefits from competition -- the *MAG Order* discourages investment in rural LEC service areas, increases the rates charged to rural LEC consumers, and specifically **determines that the Commission will not act to assist rural consumers in the realization of any benefits derived from the reduction in access charges for the benefit of IXCs.**[27] Reconsideration is warranted to rectify the result of the *MAG Order* which otherwise disregards the basic precept of the 1996 Act in order "to achieve some other

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[27] *MAG Order* at paras. 179 -190. The Alliance notes that para. 186 states that "we will diligently continue to enforce provisions of the Act which are designed to ensure that interstate services and rates offered by interexchange carriers in high-cost and rural areas are just and reasonable." Moreover, paragraph 183 states that "[u]nder the Commission's rules . . . , interexchange carriers must offer consumers in rural and urban areas the same optional calling plans." Numerous examples of factual circumstances have been brought to the attention of the Commission in various fora which unequivocally demonstrate that IXCs are not offering rates and rate plans to rural LEC subscribers that "are no higher than the rates charged by each such provider to its subscribers in urban areas."(§254(g) of the 1996 Act). The Alliance respectfully urges the Commission to initiate action to make meaningful its intent to enforce the Act in this regard.

goal."[28]

The *MAG Order* is replete with unsupported statements which conclude that the determinations which are the subject of this reconsideration request are required to "balance the principles" of Universal Service and competition. The record in this proceeding, and the *MAG Order* itself, reflects the fact that the MAG proponents attempted to develop a proposal that does not cause conflict between the principles of the 1996 Act.[29] The Commission rejected the proposal, and refused to afford parties a meaningful opportunity to offer alternatives[30] or even to comment on the determinations adopted by the *MAG Order*. As identified above, and discussed further below, the *MAG Order* proceeded toward what appears to be a predetermined destination in the absence of a factual record and supported only by faulty premises.

A. The *MAG Order* Wrongfully Imposes Modifications on Rural LEC Interstate Access Structures without Affording Any Consideration to the Historic and Effective Principles of Rate-of-Return Regulated Rate Design.

Although this proceeding was initiated to focus on the specific characteristics and needs of rural LEC rate-of-return carriers,[31] none of the determinations for which the Alliance seeks reconsideration reflect meaningful consideration of those characteristics and needs. Incorporated within the context of the *MAG Order*, on the one hand, are words that recognize that the characteristics of the areas served by rural LECs have rendered it impracticable for the rural carriers to take advantage of the incentive regulation that is used by larger carriers. On the other hand, however, the *MAG Order* foregoes any semblance of consideration or analysis of the

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[28] *See* fn., 26, *supra.*

[29] *MAG Order* at para. 7.

[30] *See, e.g.,* Alliance Reply Comments at p. 5.

[31] *See, e.g., MAG Order* at paras. 4, 28, 86. At para. 4, the order acknowledges that almost all rate-of-return carriers are rural telephone companies.

relationship of these rural market characteristics to the decisions set forth in the order.

Concurrent with the establishment of the initial price-cap regime, the Commission recognized that the nature of the areas served by the small rural carriers do not afford the opportunity for "efficiency" or "productivity" gains that are at the foundation of incentive regulation. Accordingly, the Alliance members, all small rural LECs, have remained subject to rate-of-return regulation, relying on the establishment of cost based rates to provide a meaningful opportunity to recover their costs and reasonable return on investment.

The rational prior decisions of the Commission regarding both the allocation of interstate costs and the appropriate rate design to recover those costs has well-served the nation's universal service objective. The *MAG Order*, however, disregards the rural market characteristics which constitute the basis upon which past practices and policies were formulated, and, instead, strives toward reduced access charges and rate structures that conform more closely to those established for the large carriers that benefit from incentive regulation.[32]

B. The Allocation of Interstate Joint and Common Costs and the Design of Rates to Recover Those Costs Require "Reasonable Measures."

Fundamental to the establishment of rational rate structures for any incumbent LEC is the concept of jurisdictional and service allocation of joint and common costs. While the jurisdictional and service cost allocation rules (set forth, respectively, in Parts 36 and 69 of the Commission's Rules) appear complicated, the fundamental concepts are easily understood. The plant, and associated expenses, generally required for the provision of basic telephone service is utilized by customers to make and receive local calls, intrastate toll calls, interstate toll calls, and international calls. While the establishment of connectivity to the nationwide switched telephone network is of benefit to the customer that orders the connectivity, it is a fundamental principle of

[32] *See, e.g., MAG Order* at para. 11.

rate-of return carrier ratemaking that there is also great benefit to all others who can use the same plant to call and be called by the customer. Neither recognition nor application of this basic and essential principle is discernable in any aspect of the *MAG Order*.

The fundamental concept of jurisdictional cost allocation ensures that joint and common costs are reasonably allocated on a jurisdictional basis, and that rates are established for each jurisdictional service to recover the apportioned costs.[33] Pursuant to §410(c) of the Act, matters concerning jurisdictional allocations of LEC property and expenses are referred to a Federal-State Joint Board. The text of the *MAG Order*, however, reflects a threshold confusion regarding the definition of ***interstate*** costs that has never before plagued the Commission.[34] As the Commission is fully aware, joint and common costs are neither categorized as interstate or intrastate until the application of the jurisdictional allocation process prescribed in the Commission's Part 36 Rules, as adopted pursuant to Federal-State Joint Board consideration. Throughout the *MAG Order*, however, the text refers to the Commission's high cost loop support

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[33] *Smith v. Illinois Bell*, 282 U.S. 133 (1930) ("*Smith*").

[34] The Alliance respectfully notes that the Commission's prior orders reflect a comprehensive understanding that the jurisdictional cost allocation process and the high cost loop support mechanism represented rational rate design and cost recovery to reflect the spreading of the recovery of the costs of rural LEC subscriber loops to all who benefit:

> Costs of different local exchange carriers do vary. Many of these cost variations are attributable to factors that carrier management cannot control. The Docket 80-286 Joint Board has tentatively endorsed an industry proposal to include a high cost factor in any new separations formula for the apportionment of NTS plant. . . .Such a factor would represent a percentage of the NTS costs of high cost companies that would be added to a base factor percentage to determine the portion of such a company's NTS costs that would be allocated <u>to the interstate jurisdiction.</u>

93 FCC 2d 282 at para.134 (underscoring added for emphasis.)

system as providing recovery for ***intrastate*** costs rather than allocated interstate costs.[35]

The Commission unquestionably has the authority, pursuant to the §410(c) Joint Board process, to change its allocation rules. Until it does so, however, the Commission cannot reclassify interstate costs as intrastate costs. The repeated and mistaken reference to "intrastate" is indicative of an arbitrary approach to the issue of defining whether and where "subsidy" exists.[36] State and Commission members of the Joint Boards have traditionally worked together to determine joint cost allocations in a manner that preserved and promoted universal service. Regulators have recognized and applied the clear distinction in the utilization of telephone plant in urban and rural areas in their jurisdictional allocation and rate design decisions.[37] Consistent with the *Smith* decision, federal and state regulators established "reasonable measures" to apportion joint and common plant and expenses on a jurisdictional basis that reflected both usage and value of the network for rural subscribers.[38]

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[35] *See, e.g., MAG Order* at paras. 2, 22, 27, 125, 135, and 136. Alliance representatives initially thought that the reference to "intrastate" was merely typographical error. The text surrounding several of the references, however, clarifies that the error is not clerical. The misunderstanding of jurisdictional separations reflected by this error, and reliance thereon, may likely be the source of the *MAG Order* divergence from prior Commission policy and additional areas of concern regarding the consideration of universal service issues in rural LEC service areas.

[36] The Alliance recognizes that *MAG Order* proponents will maintain that the decision does not modify jurisdictional cost allocations. The reality is, however, that the *MAG Order* effectively defeats the statutory intent of the §410(c) Joint Board process as a result of its requirement that all allocated ***interstate*** NTS costs should be recovered from rates charged exclusively to the rural end user. This result is contrary to practice, principle and statute. (*See*, fn.39,*infra* and accompanying text.) The *MAG Order* confusion in referring to the high cost loop support system as providing recovery of ***intrastate costs*** further demonstrates that the decision is based on a failure to distinguish the identification of "subsidy" from rate design issues. (*See*, Section II C., *infra*.) The Commission does not have the discretion to identify "implicit subsidy" on an arbitrary basis that would impede a rate-of-return carrier's opportunity to establish rates for services that recover costs.

[37] Within urban areas (*e.g.*, "inside and around the beltway" of Washington, D.C.), a customer is often able to call and be called by hundreds of thousands (and often millions) of other customers on a toll-free basis. Within less populated rural areas, however, customers can most often reach and be reached by only a few thousand (and sometimes only a few hundred) other customers on a toll-free basis.

[38] The full history is well known institutionally to the Commission and readily available. As a

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Historically, the jurisdictional allocation process has worked well to promote rural universal service and to maintain reasonable basic rates for rural subscribers. By establishing rules that allocate an appropriate amount of rural LEC network common line costs to the interstate jurisdiction, the portion of a rural LEC's costs that were borne by local service rates was consistent with the reality that the rural customer's local scope of service was far less than that of an urban subscriber.[39] The *MAG Order's* disregard for past practice, policy, existing rules and statute is, perhaps best exemplified by the following quote: " There is no good reason why customers of higher-cost companies should pay less than customers of lower-cost companies."[40] In the past, the Commission has fully demonstrated its understanding of the inaccuracy of this statement.

The Alliance is fully aware that the D.C. Circuit has upheld the Commission's decision

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[38](...continued)
result of pragmatic limitations, it will not be fully recounted here. As sources of comprehensive reviews of this subject matter, the Alliance respectfully refers the Commission to several publications by one of the MAG members, OPASTCO: *Keeping Rural America Connected: How Public Policy Has Created and Preserved Universal Service* (1996); and *The Telecommunications Act of 1996: Congress' New Vision for Universal Service for Rural America*, by Kathleen Wallman, President, Wallman Strategic Consulting, LLC.

[39] Prior to divestiture of the Bell System in 1984, the rural LEC recovered its allocated interstate costs through an interstate toll division of revenue process with the connecting Bell System carrier. The allocated interstate costs of the rural LEC networks were, in turn, incorporated in the expenses associated with the establishment of interstate toll rates. Accordingly, the interstate costs were ultimately spread across all interstate toll users who had the luxury of being able to call to, or to receive a call from, the rural subscriber. The divestiture of the Bell System and the implementation of interstate toll competition ended the interstate division of settlements process and established interstate access charges as its replacement. Instead of recovering interstate allocated costs through a contractual settlements process, rural LECs recovered interstate costs through the access charges that IXCs pay to receive and terminate calls through the rural LEC network. IXCs, in turn, recover their access charge expenses through the rates charged end users for long distance calls. Accordingly, the interstate expenses were still ultimately spread among all interstate toll users who have the luxury of being able to call to, or to receive a call from, rural subscribers.

[40] *MAG Order* at para. 50.

to shift a portion of a rural LEC's interstate allocated costs to the LEC's rural consumer.[41] At issue in this proceeding, however, is: (1) whether the Commission can mandate that a rural rate-of-return LEC can only establish a rate assessed to its end user customer to recover its interstate allocated NTS costs and universal service contribution; and (2) whether interstate costs in excess of a prescribed limit on the end user rate can only be recovered by the rural LEC as a "subsidy" from a new and portable universal service mechanism. The Alliance respectfully asks that the Commission reconsider these *MAG Order* actions, rescind the modification and adoption of the associated rules, and issue a further notice to address these issues. The *MAG Order* requirements are not "reasonable measures." Accordingly, reconsideration should be granted and these requirements should be rescinded.

C. Concern regarding the existing rate design for the recovery of interstate NTS costs does not support the conclusion that the existing rates recover "implicit subsidy."

As discussed above, the Alliance has identified aspects of the *MAG Order* that appear designed to achieve a specific agenda - access charge reductions - without regard to statute or public policy principles. In order to achieve this single objective, the *MAG Order* takes a leap, without basis in fact or law, to apply the Commission's decisions regarding the treatment of price cap carrier NTS costs to rural rate-of-return carriers. The Commission has not heretofore considered comprehensively the restructuring of the existing rate design for rural rate-of-return LEC recovery of interstate NTS costs. The *MAG Order*, however proceeds on the basis of an assumption that all interstate NTS costs that are not recovered from the rural subscriber must constitute "subsidy" that can only be recovered from a new and portable universal service

[41] *NARUC v. FCC*, 737 F. 2d 1095, 1112 (D.C. Cir. 1984)..

mechanism, the ICLS.[42] In order to ensure that the arbitrary agenda of access charge reductions is fulfilled to the fullest extent possible, the *MAG Order* reclassifies certain interstate costs from the traffic-sensitive category to the NTS category, thereby assuring that these costs are recovered either directly from end users or the ICLS, but not from access charges for the services associated with the allocated interstate costs.[43]

1. The Commission acknowledges that it does not know how to identify "implicit subsidy."

One of the most striking features of the *MAG Order* that demonstrates the need for reconsideration is the recognition that "identifying an amount of implicit support in our interstate access charge system to make explicit is an imprecise exercise."[44] The *MAG Order* proceeds on the basis that the Commission may make a "reasonable determination."[45] "When the FCC has failed to define the terms at all or has provided a definition that replaces a statutory command with some other standard, however, deference is inappropriate."[46] The Alliance respectfully maintains that the Commission does not have discretion under the *Chevron* standard or any other authority to require a rural rate-of-return carrier to recover costs through a subsidy program instead of through rates designed to recover costs of services provided.

The *MAG Order* does not define subsidy. With the result-oriented drive of reducing

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[42] *See, e.g., MAG Order* at paras. 3, 12, 17, 23, 33, 41, and 43 - 44.

[43] *See, e.g., MAG Order* at para. 92. The Alliance does not take issue with the Commission's discretion to establish rate design or to recategorize interstate costs. It takes issue with the decision to the extent that it denies the rural LEC the opportunity to recover its costs through the establishment of rates for its services. If the existing rate design mechanism for rural carriers is determined "inefficient" on the basis of consideration of rural LEC service area characteristics and needs, it should be corrected. Correction of the rate design can be achieved, however, without sacrificing fundamental universal service principles and arbitrarily labeling cost recovery as "subsidy."

[44] *MAG Order* at para. 130, citing *Interstate Access Support Order*, 15 FCC Rcd at 13046.

[45] *Id.*

[46] *Qwest*, Slip Opinion at 16.

access charges. the order instead merely identifies a rate design the Commission has found objectionable. It then leaps to the conclusion that the actual interstate costs recovered by the existing rate design constitute "implicit subsidy" which. the order concludes, must be recovered from an explicit support mechanism. These interstate costs. however, have been assigned to the interstate jurisdiction in accordance with established rules. No basis exists for treating the recovery of these interstate costs as a "subsidy," and thereby denying a rural LEC the opportunity to establish cost-based access rates to recover these interstate access costs.

2. No rational basis exists for the conclusion that rural LEC rate-of-return carriers can only assess rates for NTS costs to their end users.

The *MAG Order* ignores the fundamental principle that a carrier subject to rate-of-return regulation is entitled to establish rates for its services that will provide it with a meaningful opportunity to recover its reasonable costs and a fair return on its investment.[47] Moreover, the order confuses the concept of rate design and cost recovery with the identification of "subsidy" and the establishment of support mechanisms.

The *MAG Order* imposes Commission decisions regarding NTS cost recovery reached in the context of incentive based price cap companies on rural LECs and their subscribers without consideration of rural carrier and service area characteristics.[48] The Commission's determinations with respect to price cap companies presumably took into consideration the characteristics of the markets served by the carriers that sought incentive regulation. The CALLS

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[47] *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692-693 (1923).

[48] The order cites prior price cap company decisions as a basis for support of the determination to apply the same concepts to rate-of-return carriers. *See, e.g.*, *MAG Order* at paras. 62-63 citing the *Access Reform Order*. In the *Access Reform Order*, the Commission state specifically at footnote 37 that it would "initiate a separate proceeding later this year to examine the special circumstances of small and rural rate-or-return LECs." The Alliance respectfully asks that the Commission recognize that the *MAG Order* simply adopts the *Access Reform Order* without consideration of "the special circumstances of small and rural rate-or-return LECs."

decision[49] indicates that the larger carriers entered into a consensus with the Commission and other parties to adopt the price cap carrier NTS cost rate design. No such "consensus" exists in this proceeding.

While the Court has previously upheld the Commission's decision to limit a LEC's opportunity to recover a portion of its interstate access costs only from end user charges, the Commission has never before determined that the exclusive service rate available for recovery of a rural rate-of-return carrier's interstate costs can only be the end user charge.[50] This outcome is contrary to both law and the policy articulated by the Commission within the *MAG Order*: **A rural LEC should be permitted to establish rates for its interstate access services that recover its costs.**[51]

"Costs should be assigned, where possible , to those customers who benefit from the services provided by the local loop."[52] Although the *MAG Order* articulates this Commission policy, the order would effectively establish a system whereby a rural subscriber, through the assessment of the increased SLCs, will subsidize urban subscribers who enjoy the benefit of placing interstate toll calls to and from the rural local loop.[53]

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[49] *Interstate Access Support Order*, 15 FCC Rcd 12962 (2000).

[50] The Alliance recognizes that the *MAG Order* establishes a subsidy program to recover those costs that it will not permit the carrier to recover through rates. As discussed further in section II B.4., *infra*, the opportunity for recovery of residual costs through a vulnerable subsidy program is not the equivalent of correctly permitting a carrier to establish rates to recover its costs.

[51] *See* fn.15 *supra*.

[52] *MAG Order* at para. 43 citing *Access Charge Reform Order*, 12 FCC Rcd at 16013.

[53] The rural consumer's subsidization of interstate toll users is further exacerbated by the *MAG Order* discussion and treatment of rural LEC recovery of universal service contributions set forth at par. 177. The *MAG Order* misapplies the holding of *COMSAT Corp. v.FCC*, 250 F.3d 931, 938-40 (5th Cir. 2001). While this case held that LECs may not recover USF contributions through their existing access charge rates, the 5th Circuit never said that a rural LEC may not assess a charge directly to its interstate customers to recover interstate USF contributions. Rural LEC USF contributions are based on their gross interstate revenues which consist only of revenues for interstate access services. The rural LEC interstate access customers are the IXCs, and not the rural LEC subscribers. The *MAG Order* decision wrongly

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The *MAG Order* is contrary to established Commission policy that recognizes that rural end users should not bear all interstate loop costs and that the residual interstate loop costs that are not recovered from the end user should be recovered from interstate access charges:

> The purpose that the Universal Service Fund would be designed to serve would obviously be frustrated if all NTS costs were recovered through end user charges that reflect the interstate NTS costs of a particular exchange carrier. Any reduction in the local exchange rates of such a carrier would be offset by increased end user access charges. We have accordingly decided that common line costs that are assigned to the interstate jurisdiction as a result of the application of a universal service factor should be recovered through an access charge that is assessed upon interexchange carriers.[54]

Accordingly, the Alliance respectfully submits that reconsideration of the *MAG Order* is necessary to rectify those aspects of the order that would unduly burden rural subscribers. Consideration should be given to a rate design that recovers at least a portion of the interstate costs of a rural rate-of-return carrier from the access rates assessed to IXCs and, indirectly, to their toll customers that utilize and benefit from the ability to terminate and receive interstate calls transmitted through the "local loop."[55]

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[53](...continued)
prevents the rural LECs from recovering the interstate USF contribution from a discrete charge to the interstate access customers. The order limits the rural LEC recovery of this interstate cost to charges placed on the rural end user, thereby creating an implicit subsidy that results in rural consumer subsidization of interstate interexchange services. Moreover, the determination set forth in the *MAG Order* was issued without any Notice or opportunity for comment by any party.

[54] *1983 Access Order*, 93 FCC 2d at 282 para. 135. It is both interesting and revealing to note that the *MAG Order* at paras. 33, 43 and footnote 126 cites the *1983 Access Order* at 264-265 to support the notion that the recovery of NTS costs from end user charges is a "long standing goal." Reviewing the entire decision in the context of the Commission's desire to properly consider the special circumstances of rural rate-of-return carriers and their subscribers is necessary and supportive of the Alliance request for reconsideration.

[55] The *MAG Order* reliance (at para. 43) on *Texas Office of Public Utility Counsel v. FCC* (5th Circuit No. 00-60434) is misplaced. In that case, the Commission's decision to raise SLCs of price cap carrier subscribers was affirmed. The 5th Circuit Court found that the Commission had acted within its discretion only because "it sufficiently explained its reasons for increasing the SLC for residential and single-line business customers." The reasons given by the Commission related predominantly to the characteristics of service in price cap carrier areas. The Court clearly relied on the Commission's articulation of the benefits of competition that the Commission anticipated in service areas characterized
(continued...)

3. No rational basis exists for requiring rural LECs to recover NTS costs from a new support mechanism instead of rates assessed for services.

Without any basis in fact or law, the *MAG Order* mislabeled as "implicit subsidy" all NTS costs that are not recovered from end user charges.[56] In determining that a significant portion of interstate NTS costs must be recovered from a new support mechanism, the *MAG Order* attempts to mark its conclusion as one within the Commission's "discretion." It does so by creating a suggestion that reduction in the disparity in the access rates of price cap and rate-of-return carriers is necessary because disparities "may create pressure on interexchange carriers to deaverage long distance toll rates," and that reduction of disparities is required to "promote the toll rate averaging policies codified in section 254(g)."[57]

The contention that reductions in rural carrier access charge levels are necessary to ensure that rural consumers benefit from §254(g) of the 1996 Act is nonsensical and ignores the intent of the law.[58] Congress understood that disparities in access costs and rates exist between larger urban based LECs and rural LECs. It is, in fact, the reality of the higher costs to provide

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[55](...continued)
by more market driven characteristics where incumbent LECs operate under incentive regulation in lieu of rate of return regulation. The anticipated consumer benefits that constituted the basis for the Commission's exercise of discretion in *Texas Office of Public Utility Counsel v. FCC* are not present in this proceeding. To the contrary, the *MAG Order* specifically determines that it will take no action to ensure rural consumer benefits. Moreover, there is no consideration of the market conditions in the areas served by the rural rate-of-return carriers. Most enlightening in this respect is the specific disregard of the *MAG Order* for rural development and the consequent impact of multi-line business SLC increases in rural areas. *See, MAG Order* at paras. 51-56.

[56] In order to support this conclusion, the *MAG Order* relies on prior decisions regarding price cap companies wherein the Commission concluded that per minute charges were inappropriate and inefficient rate design mechanisms to recover NTS costs. Those decisions reflect no consideration either of the characteristics of the rural areas served by rate-of-return carriers or how those characteristics may be addressed by proper rate design *See, e.g., MAG Order* at para. 68, footnote 215 which cites *Access Charge Reform Order*, 12 FCC Rcd at 15998-16000, paras. 36-40.

[57] *MAG Order* at para. 64. *See, also, MAG Order* at paras. 6, 8, 18, 29, 80, and 87-88.

[58] Alliance Reply Comments, p. 7.

exchange and access service in rural company areas that constituted the principal reason for the inclusion of the statutory requirement of geographically averaged rates in the 1996 Act.

The statute requires IXCs to establish geographically average rates. The statute does not require the entire rural LEC industry to establish access charges and structures that replicate those utilized by the larger LECs that serve markets where they can avail themselves of the benefits of incentive price cap regulation. The statutory expectation that IXCs will take into account the rates that reflect the higher costs of rural carriers to provide interstate access service when fulfilling their obligation to establish toll service offerings on the same basis in urban and rural markets. Contrary to the text of the *MAG Order*, the provisions of §254(g) set forth requirements for IXCs, not "suggestions." The Act delegates to the Commission the responsibility to enforce the requirement, and not merely to "facilitate" or "promote" compliance.[59] The §254(g) requirements offer no basis whatsoever for the *MAG Order* determination to reduce access rates by reclassifying interstate NTS costs as "subsidy."[60] The Commission should grant reconsideration, issue a further notice and consider alternative rate designs that will recover the NTS costs from all customers (in addition to the rural end user) who benefit from the originating and terminating access services provided by the loop.

4. The *MAG Order* fails to establish rates in a manner that provides the proper signals to permit a potential entrant to decide whether to enter a particular market.

The *MAG Order* takes false comfort in the notion that the rule modifications it requires

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[59] *MAG Order* at para. 64. *See* fn. 27, *supra*.

[60] To the contrary, nothing in §254 suggests that a rural LEC should be prohibited from establishing rates to recover its costs. To the extent that the Commission may determine that lawfully established rates may, in fact, discourage universal service (as the *MAG Order* suggests is the result of diparities in access rates), the Commission may establish sufficient and predictable support mechanisms. The *MAG Order* provides no consideration of whether an IXC with concerns over the level of cost based rates for interstate access in rural areas should have the burden of demonstrating that it requires high cost support in order to maintain compliance with §254(g).

"will promote the public welfare by encouraging investment and efficient competition, while establishing a secure structure for achieving the universal service goals established by law."[61] While the Alliance does not take issue with whether this statement is applicable to the price cap company service areas, there is no basis for sustaining this conclusion in the context of rural rate-of-return LEC service areas. Efficient competition is not encouraged by the recovery of rural carrier interstate NTS costs through a portable USF.

Instead of establishing efficient signaling of market conditions through cost-based rates, the *MAG Order* inflates the USF, rendering the support system exposed to additional gaming. Instead of encouraging rural investment in the deployment of infrastructure, the *MAG Order* leaves the members of the Alliance and other rural LECs without stability. In fact, the *MAG Order* is explicitly clear that rural LECs have no basis to rely on the continuation of the new uncapped ICLS support mechanism or the utilization of their actual costs to determine support levels.[62] Accordingly, reconsideration is required to ensure that universal service principles are not unnecessarily sacrificed and that rural LECs are permitted to continue to establish cost-based rates for services to recover their interstate costs.

III. CONCLUSION

The Alliance respectfully maintains that three aspects of the *MAG Order*, together with the associated rule changes identified above, should be reconsidered and rescinded:

1. The determination that all non-traffic sensitive ("NTS") carrier common line ("CCL") costs must be recovered from either end user charges or a new form of universal service support mechanism called Interstate Common Line Support ("ICLS");

2. The determination that the Subscriber Line Charge ("SLC") caps for rate-of-return

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[61] *MAG Order* at para. 49, citing *Interstate Access Support Order*, 15 FCC Rcd 12962 at 12995-13002, paras. 85-99 and *Access Charge Reform* Order, 12 FCC Rcd at 15998, para. 35.

[62] *See, e.g.*, *MAG Order* at paras. 129, 133, and 134.

carriers should be increased to the levels established for price-cap carriers; and

3. The determination that rural rate-of-return LECs are required to recover universal service contributions only through end user charges.

These *MAG Order* determinations, as demonstrated above, are contrary to the principles that form the foundation for the 1996 Act.

In the absence of the requested reconsideration, the *MAG Order* will raise the rates charged to rural consumers (without providing any tangible offsetting benefit) and discourage investment in advanced technology in rural service areas. Accordingly, the Alliance requests that the Commission grant its request for reconsideration and establish a Further Notice of Inquiry. The Further Notice will provide the Commission with the opportunity to develop a record of facts related to rural LEC service area characteristics and the impact of the existing rate structures on the fulfillment of the multiple objectives of the 1996 Act. On this basis, the Commission, the rural LEC rate-of-return carriers serving the nation's higher cost to serve areas, and all parties may develop meaningful and appropriate modifications to existing rural LEC access structures through the Commission's rule making process.

Respectfully submitted,

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