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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45

TO: The Commission

COMMENTS OF THE WESTERN ALLIANCE ON FURTHER NOTICE OF PROPOSED RULEMAKING

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TABLE OF CONTENTS

SUMMARY

The Western Alliance requests that participation in any alternative regulatory plan adopted by the Commission in this proceeding be made optional for all rate-of-return carriers or, in the alternative, for those rate-of-return carriers that satisfy the statutory definition of "rural telephone company." The factors rendering incentive and other alternative regulation infeasible and impracticable for rural telephone companies are their small size, the diversity of the conditions under which they operate, their high equipment and operating costs, their lack of significant economies of scale, and their "lumpy" investment and expenditure patterns. Rather than expending its resources in a futile search for a "one size fits all" alternative regulatory mechanism, the Commission should give rural telephone companies the option of remaining subject to the rate-of-return system that has enabled them to provide high quality, state-of-the-art telecommunications service and facilities to their rural customers at affordable rates.

In addition, the Commission should not merge Long Term Support ("LTS") with Interstate Common Line Support at this time, but rather should retain the existing LTS mechanism until it is possible to determine the impact of the MAG Order upon small carriers. The impact of LTS in encouraging carriers to participate in the National Exchange Carrier Association pools will help small carriers to stabilize their revenue flows and maintain their financial viability as they adjust to the significant changes required by the MAG Order.

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TO: The Commission

COMMENTS OF THE WESTERN ALLIANCE
ON FURTHER NOTICE OF PROPOSED RULEMAKING

The Western Alliance, by its attorney, hereby submits its comments with respect to the alternative regulatory structure and Long Term Support ("LTS") issues on which the Commission sought further comment in its 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, FCC 01-304, released November 8, 2001 ("MAG Order").

The Western Alliance requests that participation in any alternative regulatory plan adopted by the Commission in this proceeding be made optional for all rate-of-return carriers or, in the alternative, for those rate-of-return carriers that satisfy the definition of "rural telephone company" in Section 3(37) of the Communications Act of 1934, as amended. 47 U.S.C. Sec. 153(37). It also requests that LTS not be merged with Interstate Common Line Support ("ICLS"), and that the existing LTS mechanism be retained until it is possible to determine the impact of the MAG Order changes upon small carriers.

The Western Alliance

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

The Western Alliance filed comments in the initial stage of this rulemaking on February 26, 2001 and reply comments on March 12, 2001. It focused these previous comments upon: (a) retention of the Path B option that would allow rural telephone companies to remain subject to rate-of-return regulation; (b) the need for the term of the modified system to be long enough to accommodate the capital expenditure patterns of small carriers; (c) opposition to the addition of an "X-factor" or other consumer productivity dividend to the proposed Path A incentive mechanism; and (d) the need for inclusion of the proposed Low End Adjustment mechanism to encourage small carriers to adopt incentive regulation.

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

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

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

Any Alternative Regulatory Plan Adopted By The Commission Should Be Optional

The Commission has correctly recognized that the "wide variation among rate-of-return carrier operating conditions" makes it "extremely difficult to establish a mandatory alternative regulatory plan for all rate-of-return carriers." MAG Order at para. 227. It has indicated its intention not to require most rate-of-return carriers to participate in any alternative regulatory plan that may be adopted in this proceeding. Rather, the Commission has asked whether participation in any such alternative regulatory plan should be "completely optional" or whether it should be mandatory only for "a subset of larger rate-of-return carriers." Id.

The Western Alliance, as noted above, has very diverse members and agrees with the Commission that rate-of-return carriers as a whole are very diverse. As the Commission has found, "rate-of-return carriers are typically small, rural telephone companies concentrated in one area, but they range in size from a few hundred lines to approximately one million [lines], and some have multiple affiliates with operations in several states." Id. at para. 4. In its White Paper 2, 'The Rural Difference" (January 2000), the Rural Task Force ("RTF") detailed the differences among the rural telephone companies that comprise the majority of rate-of-return carriers. The RTF found that such differences included significant variations in study area sizes, customer densities, and terrain and climate conditions. This diversity is particularly evident in the rural portions of the states located west of the Mississippi River where a variety of commercial and cooperative entities have employed a variety of network designs to serve a variety of sparsely populated farming, ranching, mining and residential areas and Native American reservations interspersed among a variety of climates and terrain, including mountains, plains, deserts, forests, valleys, coastal areas and frozen tundra. These differences have resulted in revenue streams, cost structures and investment cycles that vary significantly from carrier to carrier. They wholly preclude any "one size fits all" approach to incentive or other alternative regulation.

The Commission has determined that rate-of-return carriers "generally have higher operating and equipment costs than price cap carriers due to lower subscriber density, smaller exchanges, and limited economies of scale" and that they "rely more heavily on revenues from interstate access charges and universal service support." Id. In the past, it has found that these conditions render incentive regulation impracticable or infeasible for rural telephone companies and other small carriers. In its LEC Price Cap Order, 5 FCC Rcd. 6786, 6819 (1990), the Commission refused to impose price cap regulation upon small local exchange carriers, and instead made it optional for all local exchange carriers smaller than the Regional Bell Operating Companies ("RBOCs") and GTE. To date, only 13 of the approximately 1,335 incumbent local exchange carriers in the United States have elected price cap regulation. MAG Order at para. 291.

In Regulatory Reform for Local Exchange Carriers, CC Docket No. 92-135, 8 FCC Rcd 4545, 4546 (1999), the Commission noted that small local exchange carriers do not want to become subject to price cap regulation because:

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

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

Association, Inc., 9 FCC Rcd 198 (1993); and US West Communications, Inc. and Triangle Telephone Cooperative Association, Inc. et al., 9 FCC Rcd 202 (1993).

The key factors rendering incentive and other alternative regulation infeasible for rural telephone companies are their small size, lack of significant economies of scale, and "lumpy" investment and expenditure patterns. Whereas the RBOCs and other large carriers can rely upon their large size and substantial scale economies to smooth investment and expense fluctuations over their entire base of operations from year to year, rural telephone companies operating under incentive regulation would have virtually no protection against these normal fluctuations. For example, an RBOC serving hundreds or thousands of exchanges can schedule upgrades in a specific fraction of its exchanges each year, and maintain its infrastructure investment at a relatively stable level from year to year. In contrast, a rural telephone company serving seven exchanges will experience a major jump in its investment during any year in which it must upgrade or replace key facilities in one or more exchanges. Likewise, a large carrier can readily smooth significantly increased expenses or cash outlays in some of its exchanges by limiting or reducing the expenses or cash outlays of its other exchanges or its administrative offices. In contrast, a substantial increase in the expenses or cash outlays for one of the rural telephone company's exchanges is unlikely to be offset by decreases for its other exchanges, and is likely to result in a significant jump in overall company expenses or cash outlays for the year.

The lumpy expense and investment patterns of rural telephone companies are ill-suited to incentive and other alternative regulatory mechanisms. The combination of significantly fluctuating expenses and investment outlays with relatively stable price or revenue functions (that are indexed, for example, to national consumer price indexes) is a recipe for cash shortages, uncertainty, and investment and service cut-backs for rural telephone companies. If a rural telephone company is concerned that substantial and uncontrollable expense increases in one or more of its exchanges will exhaust or exceed its incentive revenues and/or cash reserves, it will not be likely to assume the risk of investing in infrastructure upgrades or expansions for any of its exchanges. It will also be likely to try to reduce financial uncertainties by limiting or reducing staffing, maintenance and other operating expenses for all of its exchanges.

Moreover, if the alternative regulatory mechanism adopted by the Commission includes an X-factor or other productivity offset, the financial uncertainties and hardships imposed upon rural telephone companies would be exacerbated. Most rural telephone companies simply do not have the size or economies of scale to accommodate productivity offsets. In addition, many rural telephone companies have previously sought to maximize their operating efficiency by outsourcing certain functions (e.g., billing) that can be performed by third parties without loss of quality or personalized service. While most RBOCS employ staffs of more than 100,000 people, the typical Western Alliance member has a full-time staff of 10-to-15 employees, and some members have as few as four full-time employees. Whereas an RBOC can increase productivity from year to year by a variety of devices (including reductions in force, increased specialization, consolidation of previously dispersed personnel or functions, and sales of less profitable exchanges), rural telephone companies do not possess remotely comparable capabilities to realize annual productivity gains. How can a small rural telephone company with a staff of 10-to-15 employees performing multiple administrative, technical and/or customer service functions at a single office increase its productivity by factor of 3, 5 or 7 percent per year for several years? Moreover, many rural telephone companies have already installed digital switches and in-house information systems, and/or have outsourced certain functions. Consequently, they have little room to increase productivity by reducing employees or replacing them with automated functions.

The Western Alliance does not believe that it is possible to devise an alternative regulatory mechanism capable of dealing flexibly with the diverse, lumpy investment and expense patterns and the lack of scale economies of the 250 Western Alliance members, much less the approximately 1,200 rural telephone companies. Rather, any conceivable price or revenue formula is likely to create some arbitrary winners and losers, while producing financial uncertainty likely to discourage the majority of rural telephone companies from making investments in new services and upgraded infrastructure. Instead of promoting rational investment and operations, the threats to a rural telephone company's financial viability from fluctuating or unpredictable costs under incentive regulation are far more likely to produce insufficient investment in new infrastructure and technologies, inadequate staffing and training, and degradation of technical and customer service.

The existing system of rate-of-return regulation and NECA pooling has accommodated the differences among rural telephone companies while maintaining stable and reasonable interstate access rates. It has produced telephone penetration rates in excess of 94-to-95 percent, both nationwide and in Rural America. Meanwhile, it has enabled rural telephone companies to bring digital switching, single party service, fiber optic facilities, buried lines and other state-of-the art facilities and services to their rural customers, often long before the RBOCs and GTE provided these features in neighboring rural exchanges.

The Western Alliance notes rate-of-return carriers, in the aggregate, serve less than 8 percent of total U.S. access lines, and receive approximately 9 percent of total access revenues. Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, 13 FCC Rcd 14238, 14244 (1998). Put simply, on a national scale, the portion of these carriers that are rural telephone companies and that would remain on rate-of-return regulation serves too few lines to have a significant impact on the total interstate access charges paid by interexchange carriers or on their resulting interstate toll rates.

The Western Alliance is aware of no evidence whatsoever that the existing rate-of-return mechanisms and NECA pools are no longer capable of promoting increased investment, quality service and/or affordable rates in rural telephone company service areas. On the contrary, rate-of-return regulation continues to promote universal, state-of-the-art service in Rural America, and should continue to be available to all rural telephone companies that wish to remain subject to it. In other words, if the rate-of-return option is not broken, the Commission should not try to "fix" it by forcing rural telephone companies to shift to an uncertain and infeasible new alternative regulation mechanism.

Taking access charges toward "0" in rural areas is not a practicable economic or regulatory policy. It ignores the high costs of serving rural areas, and sends false economic signals to prospective local exchange service providers. At the same time, the Commission needs to "encourage" interexchange carriers not to abandon or disregard rural residents, just because they are more expensive to serve. As the workings of network economics demonstrate, it is just as valuable for a resident of a low-cost area such as New York City or Washington, D.C. to be able to call his mother in a high-cost area such as rural Wyoming, as it is for her to be able to call him. AT&T and the other large interexchange carriers should not be permitted to drive a decision to mandate free or virtually free exchange access in Rural America. Rather, the Commission should retain the proven rate-of-return system as the most feasible means of ensuring that residents of all portions of the United States are fully able to use and enjoy the Public Switched Telephone Network.

The Commission has also asked whether any optional alternative regulatory plan that it may adopt should be "one-way," or whether carriers electing alternative regulation might be permitted to return to rate-of-return regulation under certain conditions. Id. The Western Alliance believes that a rural telephone company that elects the alternative regulatory mechanisms and finds that it is infeasible should be allowed to return to rate-of-return regulation. The rural customers of such a carrier should not be forced to suffer inferior service and/or outmoded facilities because the carrier made an unfortunate election. To the extent that the Commission has concerns that a few carriers might try to "game" the system by jumping back and forth between rate-of-return regulation and alternative regulation, it can: (a) limit each rural telephone company to a single return from alternative regulation to rate-of-return regulation; and/or (b) require any changes after the initial return to be made pursuant to an express waiver from the Commission.

Long Term Support Should Not Be Merged
With The New Interstate Common Line Support Mechanism

The Western Alliance opposes the Commission's proposal that LTS be merged with the new ICLS mechanism as of July 1, 2003. MAG Order at para. 272. Rather, the Western

Alliance urges the Commission to leave the existing LTS mechanism, as embodied in Section 54.901(a)(5) of the Rules, unchanged until the Commission can determine the full impact of the MAG Order and this further rulemaking upon rural telecommunications service and rates.

Whereas one purpose of LTS (to ensure nationwide comparability of carrier common line rates) may no longer be applicable after July 1, 2003, the purpose and benefits of LTS regarding the encouragement of small carriers to participate in the NECA pools will be even more critical. The NECA Common Line pool will continue to be needed to maintain stable monthly common line revenue flows for small carriers, as well as to compute and tariff end user common line charges, special access surcharges, and non-analog line port costs. In particular, as small carriers adjust to the significant changes required by the MAG Order, they will rely significantly upon the NECA pools to reduce their revenue fluctuations. The more small carriers that remain in the NECA pools, the more effective the pools will be in reducing these revenue fluctuations, as well as in minimizing the administrative burdens and costs of both the participating small carriers and the Commission. This will provide the added benefit of ensuring the financial health and viability of the small companies that are the "carriers of last resort" for many of the residents of Rural America.

Maintaining the current LTS mechanism will not disadvantage lower-cost carriers, or unduly restrict their decisions whether to leave or remain in the NECA pools. Those carriers having relatively low common line costs are unlikely to be influenced to a significant degree by the availability or non-availability of LTS. In addition, lower-cost carriers remaining in the NECA Common Line pool can adopt de-averaged subscriber line charges or file their own end user common line tariffs.

Conclusion

The Western Alliance requests that participation in any alternative regulatory plan adopted by the Commission be optional for all rate-of-return carriers or, in the alternative, for all rural telephone companies. It also requests that LTS not be merged with the new ICLS mechanism as of July 1, 2003, but rather that the existing LTS mechanism remain in place until it is possible to determine the full impact of the MAG Order changes upon small carriers.

Respectfully submitted,
THE WESTERN ALLIANCE

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Dated: February 14, 2002

CERTIFICATE OF SERVICE

I, Douglas W. Everette, hereby certify that I am an attorney with the law firm of Blooston, Mordkofsky, Dickens, Duffy & Prendergast, and that copies of the foregoing "Comments Of The Western Alliance On Further Notice Of Proposed Rulemaking" were served by hand delivery on this 14th day of February, 2002 to the persons listed below:

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