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March 12. 2003

Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Ex Parte in CC Docket Nos: 00-256, 96-45, 98-77, and 98-166

Dear Ms. Dortch:

On Tuesday, March 11, 2003, David Bartlett of ALLTEL Communications, Inc., Robert DeBroux of TDS Telecommunications Corporation, and I (collectively referred to as the "Company Representatives") met with Christopher Libertelli, Legal Advisor to Chairman Powell.

The subject of our discussion was a proposal developed by the Company Representatives regarding the alternative regulatory structure contemplated by the Further Notice of Proposed Rulemaking in the above-referenced proceedings. In this regard the Company Representatives discussed the possibility of utilizing the Commission's Part 61.39 rules as a basis to provide an additional tariff filing option for rate of return carriers without increasing any administrative or regulatory burdens on those small companies that currently qualify to utilize the Part 61.39 rules.

The Company representatives explained how the proposal would function and how benefits would result for all parties: end user customers, interexchange carriers, and the non-price cap telephone companies that are not currently qualified to utilize the Part 61.39 rules. The attached documents were provided and referred to in the course of our discussion.

Please direct any questions regarding this to me at (202)296-9055.

Sincerely,

Stephen G. Kraskin

Cc: Chistopher Libertelli, Esq.

Slide 1

Incentive Option for Rural Companies

ALLTEL
MADISON RIVER
TDS TELECOM

Slide 2

Why We Are Here

- Mid-size rural ILECs lack an interstate regulatory incentive option
  - Small companies have a 61.39 tariff option
  - Large companies have CALLS
- Our incentive plan benefits customers
  - Additional efficiencies will result in:
    - Lower rates
    - Lower universal service obligations

Slide 3

How 61.39 Currently Works

- 61.39 sets rates on historical demand and cost
  - Traffic sensitive rates retargeted every two years
  - SLC rates and carrier common line per minute rate retargeted every two years
- Eligibility restricted to subset 3 carriers with less than 50,000 lines
- Available on a study area basis

Slide 4

How 61.39 Evolved

- 61.39 originally implemented to address administrative burden of filing traffic sensitive tariffs for rural companies
- Commission extended rules to common line in recognition of “incentive” nature of 61.39

Slide 5

How Our Plan Utilizes 61.39

- Option extended to all “rural” companies
- Traffic sensitive portion unchanged
- Common line portion updated to comply with MAG changes
  - Replaces per minute recovery with ICLS
- Minimal universal service changes

Slide 6

Why Our Rural Incentive Option Makes Sense

- Updates rules to comply with MAG order
- Complements state incentive plans
- Promotes increased efficiency
- Promotes new services, such as broadband
- Improves current option for all rural carriers
- Requires minimal rule modification
- Works in NECA pooling environment

THE RURAL COMPANY TARIFF OPTION

A PROPOSAL DEVELOPED
COLLECTIVELY BY:

ALLTEL Communications, INC.
MADISON RIVER COMMUNICATIONS, LLC
TDS TELECOM, Inc.

I. INTRODUCTION: The Rural Company Tariff Option is responsive to a need that the Commission has identified. Implementation of the proposed option will address concerns of rural carriers in a manner that also serves the interests of access users and rural customers.

- In response to the Commission's Further Notice of Proposed Rulemaking set forth in the Commission's Order released November 8, 2001 in CC Docket No. 00-256, ALLTEL Communications, Inc., Madison River Communications, LLC., and TDS TELECOM, Inc. (collectively, "the Rural Carriers") have given both independent and collective consideration to the development of options available as alternative regulatory structures for rate-of-return carriers that currently have no meaningful options.
  - Specifically, rural telephone companies, as defined by the Telecommunications Act of 1996, with over 50,000 access lines, including the Rural Carriers, have no realistic alternative or incentive option available to rate-of-return regulation.
    - Given the cost characteristics of the rural geographic areas served by the Rural Carriers, it is not practicable for these companies to elect Price Caps as currently formulated.
    - Under existing rules, the Rural Carriers are not permitted to elect the use of the incentive regulation established in § 61.39 of the Commission's Rules to address the needs of rural companies, their access users, and their end user customers.
  - The Commission has long recognized that the distinct characteristics of rural telephone companies in combination with their diversity result in the conclusion that it is appropriate to establish "a continuum of increasingly incentive-based approaches which permits a company to select a plan best fitting its circumstances."[1]

[1] *In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Report and Order released June 11, 1993 (the "OIR Order"), para. 4.

- The Commission initially attempted to achieve this continuum by adopting Price Caps for larger carriers; "Optional Incentive Regulation" ("OIR") for all rate-of-return local exchange carriers as formerly set forth in § 61.50 of the Commission's Rules; and historic cost tariff filing rules for both the traffic sensitive and common line rates for companies serving fewer than 50,000 lines, as set forth in § 61.39 of the Commission's Rules.[2]
- Unfortunately, the continuum envisioned and desired by the Commission does not exist. The OIR rules did not turn out to be as useful to the rural rate-of-return carriers as both the carriers and the Commission had hoped. The availability of OIR was subsequently removed from the Commission's Rules.

♦ The need for the continuum of incentive regulation choice envisioned by the Commission, however, remains. The Rural Carriers have concluded that the Commission's existing rules and policies, with appropriate modification and application, contain the needed elements to provide the desired continuum for the Rural Carriers and other similarly situated rural companies that have no incentive regulation choice other than the existing price-cap plan which the Commission has recognized and understands to be inapplicable to their service areas.[3]

♦ Specifically, the Rural Carriers propose that the Commission adopt the "Rural Company Tariff Option" by revising its rules to permit all rural telephone companies the option in each of their study areas of electing to utilize the § 61.39 rules to establish applicable access charges.
- The Commission has previously noted the public interest benefits that have been produced by utilization of the § 61.39 rules,[4] and recognized that the rules exist both to promote the public interest and to provide incentives to local exchange carriers.[5]
- The Commission has essentially recognized in its Further Notice in the MAG proceeding, as it has previously determined, that it is appropriate and necessary to expand incentives for efficiency and innovation.
- The limitation on the application of § 61.39 Rules to carriers serving fewer than 50,000 access lines was established in 1987:

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[2] The optional application of § 61.39 to the common line rate was effectuated by the OIR Order, and reflects the Commission's intent to enhance the provision of a continuum of incentive choices to non-price cap carriers.

[3] *See, e.g.,* MAG Order, para. 86. "Rate-of-return carriers also have fewer opportunities than large price cap carriers to achieve cost savings because of their limited size, their lumpy investment patterns, and fluctuating operating expenses."

[4] "Our own review of the rates filed pursuant to Section 61.39 . . . demonstrates the success of these rules." OIR Order, para. 94.

[5] "Collectively, these revisions to our rules governing small and mid-size LECs were designed to assure reasonable rates, reduce regulatory burdens and introduce (or expand) incentives for efficiency and innovation." *In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, Order on Reconsideration, February 18, 1997, at para. 11.

- Prior to any experience with price caps or any alternative forms of incentive regulation;[6]
- Prior to any experience in observing the value of the § 61.39 rules for rural rate-of-return carriers;
- Prior to the failure of OIR to provide a viable alternative for carriers similarly situated to the Rural Carriers; and
- Prior to the adoption of the Telecommunications Act of 1996 which provides a statutory definition of "Rural Telephone Company."[7]

- The Rural Carriers note that the Commission has previously been asked to consider expanding the availability of the § 61.39 rules. A similar proposal was set forth by USTA in the course of the Commission's 1998 Biennial Review. In response, the Commission declined to adopt the proposal noting that this, and related access pricing flexibility proposals, would be better addressed in the *Access Reform* proceeding.

♦ Accordingly, it is appropriate for the Commission to consider and adopt the Rural Carrier proposal to expand the availability of the §61.39 rules to all rural telephone companies. As the Commission's experience with the § 61.39 rules has demonstrated, the adoption of the Rural Company Tariff Option will serve the public interest by providing a currently unavailable option to the Rural Carriers and similarly situated rural telephone companies. Implementation of the Rural Company Tariff Option will promote:

- Reasonable access rates;
- Reduced regulatory burden;
- Potential for reduced end user charges.

II. The minimal Rule changes required to implement the Rural Company Tariff Option are consistent with both Commission policy and the Telecommunications Act of 1996.

¨ The availability of the § 61.39 Rules is currently limited to local exchange carriers serving 50,000 or fewer access line in a given study area that are described as subset 3 carriers in § 69.602 (i.e., annual operating revenues under $40 million).

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[6] In establishing the limitation the Commission noted that it was considering forms of alternative or reduced regulation in separate proceedings.

[7] The Rural Carriers respectfully suggest that the definition of Rural Telephone Company set forth in the Telecommunications Act provides a firm basis for revision of the limitation on the application of § 61.39. There is no meaningful distinction among rural telephone companies, as defined by the Act, with respect to the very concerns and carrier characteristics addressed by the availability of the § 61.39 rules.

¨ The Rural Company Tariff Option may be implemented by substituting the following at the beginning of § 61.39:

§ 61.39 Optional supporting information to be submitted with letters of transmittal for Access Tariff filings effective on or after April 1, 1989, with respect to any study area operated by a Rural Telephone Company.

(a) *Scope*. This section provides for an optional method for filing for any study area served by a Rural Telephone Company as that term is defined in § 51.5 of this chapter.

- A similar revision is required in § 61.38 to replace the reference to the 50,000 line and subset 3 limitation with respect to the application of § 61.39.

III. Additional proposed modifications to the Commission's Rules will align the operation of § 61.39 with the implementation of the MAG decision.

♦ The Rural Carriers propose no changes to the Traffic Sensitive portion of the § 61.39 tariff option. Under existing rules, carriers filing Traffic Sensitive rates under § 61.39 base their rates on historical costs and demand. For the initial § 61.39 tariff filing, a carrier uses actual costs and demand for the previous calendar year. For subsequent filings, the carrier uses the actual costs and demand for the two previous calendar years. § 61.39 uses regulatory lag to provide an incentive to the ILEC to control costs and stimulate demand, while the customers benefit from the self-correcting nature of the plan. Efficiencies gained during the tariff period are reflected in subsequent tariff filings.

♦ In their review of the § 61.39 rules, the Rural Carriers noted that the implementation of the MAG Order affects the operation of § 61.39 with respect to the common line option.

- Under the existing § 61.39 rules, end user charges are set at the lower of cost or subscriber line charge ("SLC") caps; and the remainder of the common line revenue requirement is to be recovered through the CCL charge. The MAG rules, however, have eliminated CCL charges except for the small amount remaining for the final SLC cap transition; ICLS has been created to recover the residual.
- Accordingly, the § 61.39 rules should be revised to enable the electing company to recover the residual Common Line revenue requirement through the ICLS, consistent with the changes in the MAG order.
- The Rural Carriers offer a procedure below to accomplish this in a manner consistent with the underlying policy intent of the Commission when it expanded the § 61.39 option to include the CCL rate.
- In the current environment of stagnant line growth, rural rate-of-return carriers should be provided with expanded and additional incentives to control costs. The Rural Carriers have developed a proposed mechanism to revise § 61.39 in a manner that both provides that incentive, and benefits the customers by resetting support every two years based on efficiency gains of the previous two-year period.
- Specifically, the Rural Carriers propose to revise § 61.39 with respect to the establishment of the CCL rate (and to make consistent rule changes in § 54 and § 69 of the Commission's Rules) to provide as follows:
  - ■ Establish per-line Common Line support at the historical level of costs divided by the historical level of access lines.
  - ■ The formula would initially be established by utilizing the historical period

interstate Common Line revenue requirement, as defined in the FCC Part 69 rules, which includes the Line Port costs transferred from Local Switching and TIC reallocations.

■ The Interstate Common Line revenue requirement for the historical period would be reduced by end user revenues, the special access surcharge, the line port costs associated with ISDN service in excess of basic analog service[8], and payments to USAC for universal service funding assessments.

■ No reduction is required to offset CCL revenue; this result occurs because this plan will not be implemented until after the CCL charge is completely eliminated on June 30, 2003.

■ A company electing § 61.39 for Common Line would establish an interstate Common Line revenue requirement per access line, net of SLCs, special access surcharges, ISDN Port charges, and USAC assessments. This per line amount, times the actual access lines, would become the company's Common Line revenue requirement during the optional tariff period and would be used as a final total amount for all interstate Common Line amounts.

■ Under this proposed mechanism for addressing the common line revenue requirement within the framework of § 61.39, an electing company would receive Common Line revenue for the applicable study area from the following sources for the duration of the tariff period:

Common Line Revenue Source	***Determination of Amount***
Subscriber Line Charges	Based on historical year costs, with rate development consistent with current SLC rules, using SLC caps in the rules.
Per-Line Common Line Settlement Amount	Historic year costs, adjusted for SLCs, special access surcharges, and ISDN port charges.
Special Access Surcharges	Based on historical period rate development.
ISDN Line Port Charges	Based on historical period rate development.
Universal Service Charges (FUSC)	Recovery based on current period assessments from USAC.

IV. Public Interest Benefits Result from the Implementation of the Rural Company Tariff Option.

♦ The adoption of the Rural Carrier Tariff Option will expand the availability of a proven incentive regulation alternative to study areas served by all rural telephone companies. In their consideration of § 61.39 as an expanded option available as part of a continuum of incentive options, the Rural Carriers offer a mechanism to ensure that Common Line revenue requirement

[8] *See*, § 69.130 of the Commission's Rules.

recovery continues to be achieved in a manner consistent with the Commission's goals. The adoption of the proposal otherwise is limited in its impact on existing mechanisms:

- Local Switching Support: The Rural Carrier proposal does not contemplate or require changes to the methodology by which Local Switching Support (LSS) is calculated and recovered. This element will continue to be paid based on estimated costs for the year, subject to true-up. Accordingly, the proposal has no impact on the manner in which LSS is treated under the existing rules.
- High Cost Loop Funding: The Rural Carrier proposal does not contemplate or require any changes to the High Cost Loop Funding (HCLF). The Rural Carriers respectfully submit that any current or subsequent consideration by the Commission regarding HCLF should be separate and apart from the consideration of this proposal. Consideration of any issues or proposals regarding HCLF should not be permitted to delay the expedited adoption of the Rural Company Tariff Option and the resulting benefits of expanding the availability of § 61.39 to all rural companies.
- NECA Pooling and Incentive Regulation: The Rural Carriers anticipate that the Rural Company Tariff Option will work well with the NECA pooling process.
    - Companies electing § 61.39 incentive regulation for Traffic Sensitive rates would settle with the Pool based on per-minute or per special access line settlement ratios.
    - No administrative burden will result for companies electing the Rural Company Tariff Option for Common Line. Participation in the NECA Common Line pool would be administratively simple; these companies would simply settle with NECA based on the per-line settlement amounts (as proposed in Section III above).

♦ The adoption of the Rural Carrier Tariff Option will not be disruptive to other existing policies, practices or procedures:

- All Rural Telephone Companies would be able to elect to apply § 61.39 rules to Traffic Sensitive, Common Line, or both, by study area in the same manner that a more limited subset of rural telephone companies are able to do today.
- As under the existing § 61.39 rules, the resetting of rates every two years will provide both protection to the electing rural telephone companies and benefits to IXCs.
- In the MAG proceeding the Commission acknowledged the concerns of rural telephone companies with respect to any prospective mandated incentive regulation. The Rural Carrier proposal is optional for all rural non-price cap companies and will not impact any rural company in a negative manner. The adoption of the Rural Company Tariff Option does not and should not impose any additional regulation or administrative burden on rural companies currently eligible to utilize § 61.39.
- The Rural Carrier Tariff Option provides an incentive tariff filing option for many rural company study areas that currently have no viable incentive option. The proposed option is founded on existing rules and polices and results, as the Commission has contemplated, in the expansion of a continuum of incentives available to non-price cap carrier.
- The Rural Carrier Tariff Option can be easily adopted and implemented without administrative burden to any party. The proposed rule changes to expand the application of § 61.39 are very straight-forward. The remainder of the rule changes proposed by the

Rural Carriers address changes in an efficient manner consistent with existing policy to align § 61.39 with the changes in CCL revenue requirement recovery that result from the implementation of the MAG Order.

V. The Commission Can Obtain Maximum Public Interest Value from the Rural Company Tariff Option by Expedited Adoption that Enables Carriers to Elect to Use the Option Effective July 1, 2003.

- The Rural Carriers respectfully request that the Commission afford the Rural Company Tariff Option expedient consideration in order to ensure that the required rule changes are effective on a timely basis that enables rural telephone companies the opportunity to elect to implement this plan concurrent with the election for interstate tariffs effective July 1, 2003.

CONCLUSION

- Adoption of the Rural Company Tariff Option will expand the availability of a successful incentive plan that has proven to address the needs of rural telephone companies in a manner that advances the public interest. The expansion of the availability of § 61.39 provides a missing element on the Commission's intended continuum of incentive regulation alternative designed to encourage efficiencies and reasonable rates for both access customers and end user customers.
- For an electing company, § 61.39 provides a strong incentive to operate efficiently during the tariff plan. As an incentive, the rural company is able to keep any additional revenues earned while under incentive regulation. As a result of the gain in efficiencies, the access customer benefits. Rate reductions are reflected at the end of the first tariff period when the carrier files new rates based on the two-year period since it last filed rates. End users will benefit from § 61.39 filings through lower SLC rates and/or lower universal service funding requirements.
- When the electing company files its new rates under § 61.39, the company uses the two-year historical period, costs and demand, to establish its rates for the next tariff period. As a result, its operating efficiencies during the initial tariff period translate into lower rates to carriers during the second tariff period. This result provides a powerful incentive to continue to operate more efficiently. The Rural Carriers respectfully submit that the public interest will be well served if this strong and successful incentive currently available to some rural telephone companies is made available to all rural companies by the Commission's expedient adoption of the Rural Company Tariff Option.