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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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:

This is an *ex parte* communication in the above-referenced proceedings submitted on behalf of ALLTEL Communications, Inc., Madison River Communications LLC, and TDS Telecommunications Corporation (collectively referred to as the "Mid-Size Companies"). Representatives of the Mid-Size Companies have previously met with Commission Staff and other parties to discuss their collective efforts with respect to the development of an alternative regulatory structure contemplated by the *Further Notice*.

As a result of these efforts, the Mid-Size Companies submitted a detailed proposal on January 31, 2003, initially entitled "The Rural Company Tariff Option." As a result of subsequent *ex parte* communications, the review of the full record in this proceeding, and discussions with other parties, the Mid-Size Companies have modified their proposal and attach hereto "**The Rate-of-Return Carrier Tariff Option**." The modification is limited and straight-forward; the purpose of the modification is to ensure that all carriers that are not required to participate in price caps are permitted to utilize the proposed option submitted by the Mid-Size Companies.

As explained in detail in the attached proposal, **The Rate-of-Return Carrier Tariff Option** utilizes the Commission's Part 61.39 rules as a basis to provide an additional tariff filing option for all 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. Incorporated into the attached proposal

is detailed explanation of how **The Rate-of-Return Carrier Tariff Option** will function and how benefits will result for all parties: end user customers, interexchange carriers, and the Mid-Size Companies and other rate-of-return that are not currently qualified to utilize the Part 61.39 rules.

The attached proposal ***is identical*** to the proposal initially set forth by the Mid-Size Carriers with the exception of a single modification to ensure the availability of the proposed option to all rate-of-return carriers that currently have no incentive regulation option. The initial draft proposal submitted by the Mid-Size Companies on January 31, 2003, proposed to extend the Part 61.39 rules to all incumbent local exchange carriers defined as "rural" by the Telecommunications Act.

In the course of subsequent *ex parte* meetings and discussions with other parties it became apparent that the utilization of the "rural telephone company" definition resulted in unintended limitations. The application of the Act's "rural telephone company" definition as a qualifier for utilization of the alternative tariff filing option set forth in part 61.39 resulted in preventing the utilization of the option in areas served by a small number of local exchange carriers with characteristics and service areas very similar to those of the Mid-Size Companies. Accordingly, the attached revision removes this limitation and thereby eliminates the resulting unintended consequences of utilizing the "rural telephone company" definition. The revised proposal ensures that all carriers not required to participate in price caps will have available the Part 61.39 tariff option that has long served as incentive regulation for a large subset of rate-of-return carriers.

Consistent in every other respect with the initial draft proposal submitted on January 31, 2003, the attachment also specifically identifies the limited changes in the Commission's rules required to implement the proposal. The Mid-Size Companies respectfully urge timely consideration that will enable the Mid-Size Companies and other rate-of-return carriers the opportunity to elect to implement this plan concurrent with the election for interstate tariffs effective July 1, 2003.

The complete record of this proceeding demonstrates that all parties have had notice and full opportunity to comment on the potential modification of Part 61.39 as a means to provide a form of incentive regulation to all rate-of-return carriers.1 The Mid-Size Companies do not suggest that the

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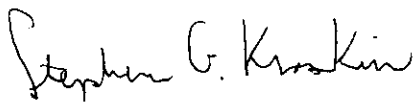
1 *See, e.g.*, **Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166,** released November 8, 2001, footnotes 545 and 546 at para. 204; and "Comments of NRTA, OPASTCO and USTA" filed in this proceeding on February 14, 2002, at pages 14-16, providing support for the very concept set forth in the Mid-Size Companies' Rate-of-Return Carrier Tariff Option. In addition, the Mid-Size Companies have submitted numerous Notices of *ex parte* meetings with members of the Commission's Staff in addition to the January 31, 2003 *ex parte* submission of their incentive proposal. No party has suggested any basis for denying the availability of this option that has long been available to a large subset of rate-of return carriers.

proposed Rate-of-Return Carrier Tariff Option will, by itself, provide sufficient and complete incentive regulation for those incumbent local exchange carriers that are not required to operate pursuant to price caps. The Mid-Size Companies view the proposed adoption of this proposal as a beginning that can be achieved on a timely basis in this proceeding. Within the context of the Commission's consideration of intercarrier compensation in CC Docket No. 01-92, the Mid-Size Companies fully expect the continued consideration and development of rate designs and associated forms of regulation as new and additional alternatives to traditional rate-of-return regulation.

On the basis of the record that has been developed in this proceeding, however, the Mid-Size Companies respectfully request and urge the adoption of the Rate-of Return Carrier Tariff Option. The Mid-Size Companies have demonstrated that the public interest will be served by expanding the availability of the tariff filing option that is already set forth in Part 61.39 of the Commission's Rules to all carriers that are not required to participate in price caps. The timely availability of this tariff filing option will send a welcome and needed message not only to the Mid-Size Companies, but to all similarly situated rate-of return carriers that will affirm the Commission's intent and desire to encourage infrastructure investment by these companies in the rural and secondary markets that they are committed to serve.

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

Sincerely,



Stephen G. Kraskin

Enclosure

cc: Christopher Libertelli, *Office of Chairman Powell*
Matthew Brill, *Office of Commissioner Abernathy*
Lisa Zaina, *Office of Commissioner Adelstein*
Jessica Rosenworcel, *Office of Commissioner Copps*
Dan Gonzalez, *Office of Commissioner Martin*

*Wireline Competition Bureau:*
Carol Mattey
Jane Jackson
Rich Lerner
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Doug Slotten
Jay Atkinson
Paul Moon

# THE RATE-OF-RETURN COMPANY TARIFF OPTION

*A PROPOSAL DEVELOPED*

*COLLECTIVELY BY:*

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

## I. INTRODUCTION: The Rate-of-Return Company Tariff Option is responsive to a need that the Commission has identified. Implementation of the proposed option will address concerns of the non-price cap rate of return carriers. Adoption of this proposal will serve the interests of access users and end user customers of rate of return carriers, and also foster the provision of universal and advanced services in rural areas.

- 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 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, rate-of- return carriers, including the 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 Carriers, it is not practicable for these companies to elect Price Caps as currently formulated.
    - Under existing rules, the 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 their companies, their access users, and their end user customers.
  - The Commission has long recognized the distinct characteristics of companies that have remained on traditional rate-of-return regulation, and that the general rural nature of their service areas 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]

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[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 never materialized . 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 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 Carriers and other similarly situated 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 Carriers propose that the Commission adopt the "Rate-of-Return Company Tariff Option" by revising its rules to permit all rate-of-return 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 Carriers; and

- The 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 Carriers' proposal to expand the availability of the §61.39 rules to all rate-of-return telephone companies. As the Commission's experience with the § 61.39 rules has demonstrated, the adoption of the Rate-of-Return Company Tariff Option will serve the public interest by providing a currently unavailable option to the Carriers and similarly situated rate-of-return telephone companies. Implementation of the Rate-of-Return 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 Rate-of-Return 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).

♦ The Rate-of-Return 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 Telephone Company otherwise subject to § 61.38 .

(a) *Scope.* This section provides for an optional method for filing for any study area served by a carrier that is otherwise subject to § 61.38.

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

- 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 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 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 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 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 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[7], 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 Rate-of-Return Company Tariff Option.

- The adoption of the Rate-of-Return Company Tariff Option will expand the availability of a proven incentive regulation alternative to study areas served by all current rate-of-return telephone companies. In their consideration of § 61.39 as an expanded option available as part of a continuum of incentive options, the Carriers offer a mechanism to ensure that Common Line revenue requirement 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 Carriers' proposal does not contemplate or require changes to the methodology by which Local Switching Support (LSS) is calculated and

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

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 Rate-of-Return Company proposal does not contemplate or require any changes to the High Cost Loop Funding (HCLF). The 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 Rate-of-Return Company Tariff Option and the resulting benefits of expanding the availability of § 61.39 to all rural companies.
- NECA Pooling and Incentive Regulation: The Carriers anticipate that the Rate-of-Return 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 Rate-of-Return 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 Rate-of-Return Carrier Tariff Option will not be disruptive to other existing policies, practices or procedures:

- All Rate-of-Return 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 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 Rate-of-Return Carrier proposal is optional for all rural non-price cap companies and will not impact any rural telephone company in a negative manner. The adoption of the Rate-of-Return 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 Rate-of-Return Carrier Tariff Option provides an incentive tariff filing option for many Rate-of-Return 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 carriers.
- The Rate-of-Return 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 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 Rate-of-Return Company Tariff Option by Expedited Adoption that Enables Carriers to Elect to Use the Option Effective July 1, 2003.

- The Carriers respectfully request that the Commission afford the Rate-of-Return 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.

## VI. CONCLUSION

- Adoption of the Rate-of-Return 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 Rate-of-Return 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 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 incumbent local exchange carriers that are not required to utilize price caps by the Commission's expedient adoption of the Rate-of-Return Company Tariff Option.