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VIA ELECTRONIC FILING
Marlene H. Dortch, Secretary
Federal Communications Commission
Office of the Secretary
c/o Vistronix, Inc.
236 Massachusetts Avenue, N.E., Suite 110
Washington, D.C. 20002

Re: **Ex Parte Filing**
Docket No. 96-45, Universal Service Joint Board
Remand of *Qwest v. FCC*

Dear Ms. Dortch:

The Vermont Public Service Board hereby submits this *ex parte* filing regarding support to nonrural carriers, a matter under consideration since July 2001, when the 10th Circuit Court of Appeals, in *Qwest v. FCC*,[1] remanded the Commission's Order establishing the nonrural support system for further consideration. The Maine Public Utilities Commission joins in these comments.

The 10th Circuit Court held that the FCC had not adequately explained several aspects of its existing support system for nonrural carriers. It remanded the FCC's decision to allow the Commission an opportunity to correct four problems. The fourth problem was that the FCC had not adequately explained how federal "high-cost model support" to nonrural carriers, as one piece of a larger federal support system for universal service, "will interact with other universal-service programs."[2] The court remanded the FCC's decision, in part, to allow it to explain "its complete plan for supporting universal service."[3]

The Commission has referred the three other remand issues to the Joint Board. Since the Commission is approaching the anniversary date of the Joint Board Report and may soon be

[1] *See Qwest Corporation v. FCC,* 258 F.3d 1191 (10th Cir. 2001) ("*Qwest*").

[2] *Id.* at 1201.

[3] *Id.* at 1205.

deciding the 10th Circuit remand issues, we submit this filing in order to place information on the record regarding the fourth issue.

At the time the FCC adopted the Ninth Order in CC 96-45, it had not resolved or finalized its plans for two other parts of its overall universal service support system for carriers, its plan to convert implicit support contained in access charges into explicit support (the "Interstate Access Support" program) and its plan for supporting rural telephone companies (the Interstate Common Line Support program). The Court could not determine whether the FCC's USF plan was sufficient, in part because it could not examine how the separate components of the various carrier support programs functioned with respect to one another.[4]

At this point, the FCC has restructured interstate access support and acted on the Rural Task Force Report to determine a method for supporting rural telephone companies. The FCC's USF programs cannot be reconciled. For example, the programs do not identify areas with "high-cost" in need of support in a consistent manner. A carrier's costs in a state may be deemed "high" and requiring support in one plan, but the identical type and size of costs may receive no, or considerably less, support in another plan. In fact, if costs are classified as "interstate" or are incurred by a rural company, they are supported at far more substantial levels than the same costs under the FCC's high-cost model program for nonrural companies. These results suggest that the FCC has not provided sufficient support to customers in rural high-cost areas served by nonrural companies.

The FCC Provides Widely Different Levels of Support for the Same Cost, Depending on Whether the Cost is Classified as "Interstate" or "State"

The 10th Circuit could not consider the relationship between the support provided under the cost model and implicit support built into interstate access charges because the FCC had not yet converted the implicit support into an explicit fund.[5] The Commission has now restructured interstate access, in part by adopting two new explicit universal service support programs for those interstate costs, the "Interstate Access Support" program and the "Interstate Common Line Support" program.

We analyzed how support for "interstate access" (or, more accurately, interstate costs) compares to support for "state" costs. All nonrural carriers must separate their costs into an intrastate (or "state") portion and an interstate portion under Part 69 rules. Separation factors vary somewhat across companies, but most ARMIS companies[6] separate their plan and expenses similarly, with about 73% assigned to state and 27% to interstate.[7] In other words, about 73% of their costs are classified as "state" and 27% are classified as "interstate."

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[4] *Id.* at 1203-1204.

[5] *Id.*

[6] "ARMIS Companies" comprise the largest telecommunications carriers.

[7] Variation from these means is not significant for present purposes. Among ARMIS companies in 2002, the state separation factor for total plant varies from 59% to 78%. For expenses it varies from 61% to 79%. This variance is inconsequential in comparison to the support variations discussed below.

This information permits comparison of relative support levels for state costs and interstate costs. We grouped support programs by cost jurisdiction. On the state costs side, we included High-Cost Model Support[8] and Hold-Harmless Support. For "interstate" costs we included Interstate Access Support and Interstate Common Line Support (which is provided to only a few nonrural carriers). We then compared the level of support provided to costs for both the state and federal classifications.

Our analysis leads us to conclude that support for "interstate" costs is considerably greater than support for "state" costs. As noted above, state costs are 73% of the total. Support for these state costs averages $0.16 per line per month. The interstate jurisdiction, by contrast, has 27% of the costs and receives support of $0.20 per line per month. It appears that federal support covers interstate costs 240% better than it covers state costs.[9] Regression analysis reinforces this conclusion. The regression line shows that when support for interstate costs is increased by $1.00, support for state costs increases by $1.89. Since states also get 73% of the costs, however, one would expect this ratio to be $2.70 to $1.[10]

Building further on this same data, we also examined the consistency of the support relationship across carriers. Since cost separation factors are relatively uniform nationwide, a carrier with high unseparated costs per line probably has high costs per line in both jurisdictions. A low-cost carrier should have low costs in both jurisdictions. Accordingly, a well-balanced support system would show a high correlation between its support for interstate costs and its support for state costs. High-cost carriers would receive support in both jurisdictions; low-cost carriers would not receive support in either.

Our second conclusion is that support for state costs and support for interstate costs are only weakly related, with large unexplained differences in many cases. The correlation is 0.41. As a result, support for interstate costs explains only 17% of the variance of the support given to state costs. Individual cases illustrate the largely random relationship between the two kinds of support:

- Many states receive substantial support where the cost is "interstate," but no support where the service cost is "state."
  - Of 52 potential "states" supported,[11] 47 receive support for "interstate" costs. Only eight receive support for "state" costs.
  - Virginia receives $0.84 per line and Oregon receives $0.75 per line for "interstate" costs. Neither receives any support for "state" costs. A similar situation exists for Kentucky and Colorado.

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[8] High cost model support is originally calculated based on unseparated costs, but then is multiplied by 76% in order to support only state costs. 47 C.F.R. § 54.309(a)(4).

[9] 240% = ($0.20 / 0.27) / ($0.16 / 0.73) – 1

[10] 2.70 = 73% / 27%

[11] The list includes all 50 states plus the District of Columbia and Puerto Rico.

- Conversely, some states receiving little support for “interstate” costs receive unexpectedly high support for “state” costs.

  - Mississippi receives $6.99 per line per month of “state” support, but only $0.86 for “interstate” costs. If Mississippi were on the trend line, its support for “state” costs would be $1.61. In other words, Mississippi’s “state” support is more than four times what one would predict knowing its “interstate” support.

  - Puerto Rico is an even more extreme case. Puerto Rico receives $6.25 per line per month in “state” support. Based on its “interstate” support of $0.10, one would expect only $0.18 of “state” support. Therefore, Puerto Rico’s “state” support is approximately 35 times what one would predict knowing its “interstate” support.

In summary, we conclude that 1) support for interstate costs is substantially greater than support for state costs, and 2) support for state costs and support for interstate costs are only weakly related, suggesting a fundamental inconsistency in policy or measurement of cost; and numerous cases exist of unexpectedly high support in one jurisdiction and unexpectedly low support in the other. These conclusions suggest that the two types of support programs for nonrural carriers cannot be reconciled and that support to the state jurisdiction is insufficient.

Support to Rural High-Cost Areas Varies Widely Depending on Whether the Area Is Served By a Small or Large Company

The Tenth Circuit could not consider the relationship between support levels for “rural carriers” and “nonrural carriers” because the FCC had not finalized its rural carrier program at that time.[12] Now, however, the Commission has acted on the Rural Task Force report.

We analyzed how support for rural carriers compares with support for nonrural carriers as a means of assessing whether the nonrural support mechanism yields sufficient support and reasonably comparable rates. We have found that the evidence overwhelmingly demonstrates that a rural high-cost area is likely to receive much more federal support if the area happens to be served by a small company.

The term “rural telephone company” has been widely understood as synonymous with “rural customer.” In reality, the two terms are quite different. First, the term “rural telephone company” is over-inclusive because some “rural telephone companies” have few or no rural customers. To be a “rural telephone company” under the statute, a company doesn’t have to serve a rural area; it is enough to be small.

[12] *See Qwest* at 1204.

Even more troubling, however, is the fact that the term “rural telephone company” is under-inclusive and excludes most rural areas. As shown in the following table,[13] “rural telephone companies” serve about 14 million rural customers.[14] Contrary to popular understanding and common usage, about 55 million rural customers are served by large so-called "nonrural" companies.[15] Thus arises an apparent paradox: while the typical customer of a “rural company” is rural, the typical rural person gets his or her telephone service from a “nonrural company.”

	Large "Nonrural" Carriers	Small "Rural" Carriers
(A) Percent of customers who are rural	21%	73%
(B) Customers as % of U.S. lines	93%	7%
(C) Rural customers as % of U.S. lines (= A x B)	19.5%	5.1%
(D) Rural population served (= C x 281 MM)	54.8 MM	14.4 MM
(E) Annual support for intrastate-separated costs[16]	$316 MM	$1,477 MM
(F) Support per rural person per month (= E/D/12)	$0.48	$8.57

The bottom row of the table shows the imbalance of federal support. Rural citizens served by small companies receive $8.57 of support per month. Rural citizens served by large companies get $0.48. The ratio is approximately 18 to one, a difference that arises largely from explicitly discriminatory universal service policies.

Local switching support is the most obvious example of overt discrimination. It is offered to companies with fewer than 50,000 customers, regardless of their overall costs, merely based on company size. Such policies overtly discriminate against the rural customers of large companies and they have nothing to do with universal service goals identified in the Act.

This support disparity implicitly relies upon the states to create fund transfers between urban and rural areas. In many states this is accomplished through rate averaging; other states have adopted their own high-cost funds. But in either case rural states like Vermont, Maine and

[13] Hobbs, Vicki and Blodgett, John, “The Rural Differential: An Analysis of Population Demographics in Areas Served by Rural Telephone Companies,” Rural Policy Research Institute, Research Report No. P99-8, August, 1999, at 2-3. See: http://www.rupri.org. (“RUPRI Study”)

[14] The RUPRI Study classifies the “rural” population as population *not* officially classified as “urban” in the 1990 census. As defined in the 1990 census, the urban population comprises all persons living in urbanized areas or in places of 2500 or more. *See* RUPRI Study, p. 2, fn.4.

[15] In many parts of the country, including Maine, “rural telephone companies” are actually suburban companies that have lower costs than large companies serving nearby rural areas.

[16] This information is based on USAC data for 4Q2003. High-cost loop support to rural carriers is $265.1 MM, plus $1.6 MM “safety net additive” support. Local switching support, provided only to companies with 50,000 or fewer lines (all “rural” companies) is $102 MM. The rural company quarterly total is therefore $369 MM for an annual total of $1,477 MM. For nonrural companies, “High-Cost Model” support provides $51.1 MM for incumbent companies. An additional $28 MM is provided in hold-harmless support to nonrural companies. The nonrural quarterly total is $79.1 MM for an annual total of $316.4 MM.

Montana do not have any large cities with low costs. In these states, both rate averaging and state universal service programs merely produce high rates for everyone.

As a result, a rural customer's support, and hence rates, depend principally on the ownership pattern of the state's telephone network. In states with many small rural companies, support flows freely, and high cost areas are supported by the national pool of federal funds. But in states with rural areas served by large companies, federal support is generally either not available at all or is limited; and support for the state's high-cost areas generally must come from that state's own urban customers. Anchorage, Alaska and Burlington, Vermont illustrate this difference. Anchorage is served by a nonrural company, and its costs are low, consistent with its relatively high customer density. Quite properly, the Anchorage ILEC gets no federal high-cost support. But the rest of Alaska is served by rural companies, some with very high costs, that receive support based on their own individual study area costs. The costs in Anchorage are not considered, and $83 million of federal support flows annually to the parts of Alaska served by these rural companies. In the end, Anchorage customers pay rates that recover only the costs of telephone service in Anchorage.[17]

Burlington, Vermont, another low-cost area, is also served by a nonrural company, in this case Verizon. But Verizon also serves most of rural Vermont as well. Under the nonrural carrier support mechanism, support for nonrural companies is based on the difference between the *statewide* average cost and the national average cost. Low costs in Burlington offset high cost areas elsewhere in Vermont. As a result, Verizon-Vermont's support is reduced, and local rates in Burlington are higher.[18] In the end, Burlington customers pay rates not only to recover the costs of their own telephone service in Burlington, but to make an extra contribution toward the high costs of phone service in rural Vermont.[19]

The FCC's nonrural carrier plan is comparatively under-funded because it requires costs to be averaged statewide before determining need. In contrast, the rural carrier plan does not require customers in lower cost urban areas of the state to offset the high costs of rural areas. Consequently, the rural carrier fund is substantially larger and provides much more support per line.

The difference in funding is less pronounced in those Western and Midwestern states where rural areas are served by small companies including cooperatives. For example, Iowa has more than 150 independent telephone companies. This provides a great financial advantage to customers in a state like Iowa, whose rural companies receive $71 million of support annually. Vermont has only nine rural companies, and most of its rural customers are served by Verizon.

These examples raise serious questions as to whether the support provided to nonrural companies in states like Maine and Vermont is sufficient. So far as we know, the Commission

[17] Anchorage customers also contribute to the federal universal service fund at the nationally uniform rate.

[18] High cost model support awarded to Verizon-Vermont, to the extent it exceeds the base support level existing in 1999, is directly passed on to customers as explicit bill credits.

[19] In Vermont, this contribution is currently implicit and takes the form of rate averaging. Some states have explicit universal service funds to replace this implicit contribution mechanism. Burlington customers also contribute to the federal universal service fund at the nationally uniform rate.

has not done any analysis to respond to these issues. Without that kind of analysis, the FCC cannot show that the support provided nonrural carriers is sufficient under Section 254. The incompatibility of the different components of federal support places the sufficiency of the nonrural support mechanism seriously in doubt.

Sincerely,

Elisabeth H. Ross

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