

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

In the Matter of)	
)	
Elimination of Rate-of-Return Regulation of Incumbent Local Exchange Carriers)	RM-10822
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45
)	

**REPLY COMMENTS TO PETITION FOR RULEMAKING
TO ELIMINATE RATE-OF-RETURN REGULATION
OF INCUMBENT LOCAL EXCHANGE CARRIERS**

Valor Telecommunications of Texas, L.P. (“Valor”) submits the following Reply Comments in response to Western Wireless Corporation’s (“Western Wireless”) *Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers* filed on October 30, 2003 (“*Petition*”).¹

The few parties supporting Western Wireless’ proposals ignore the difficulties that local exchange carriers (“LECs”) face when serving rural areas. Rate-of-return regulation can be the most effective method for regulating small to mid-sized LECs. These parties’ assertions regarding the ineffectiveness of this type of regulation are completely unfounded. Further, various commenters’ proposals to move towards a forward-looking cost mechanism for distributing Universal Service funding to rural carriers will not resolve the alleged problems with the Universal Service Fund (“USF”) nor do they ensure all consumers will continue to have access to basic telecommunications services, as required by Congress. Accordingly, Valor respectfully requests that the Commission deny Western Wireless’ *Petition*.

¹ Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers, Western Wireless, RM-10822 (filed Oct. 30, 2003) (“*Petition*”).

I. RATE-OF-RETURN REGULATION CAN BE THE MOST EFFECTIVE MECHANISM FOR REGULATING SMALL AND MID-SIZED LOCAL EXCHANGE CARRIERS.

To date, rate-of-return regulation has been an effective method of ensuring small to mid-sized LECs charge reasonable rates.² Contrary to several commenters' assertions, rate-of-return LECs' rates are not inflated. Furthermore, the incentive regulation plans proposed by commenters do not adequately address the market realities facing small and mid-sized LECs.³ That said, Valor is not opposed to the adoption of an incentive-based regulatory structure that takes into account the unique circumstances that small and mid-sized LECs face. To that end, Valor urges the Commission to reject Western Wireless' and other commenters' current incentive-based regulation proposals, and actively pursue the incentive-based proposals under consideration in the *MAG Proceeding's Second Further Notice of Proposed Rulemaking* adopted this week.⁴

A. Rate-of-Return LECs' Rates are Not Inflated.

Valor is encouraged that the Commission, subsequent to the filing of Western Wireless' *Petition*, has reaffirmed the validity and importance of rate-of-return regulation. In the *MAG Proceeding*, the FCC modified its rules to increase the opportunities for operational and structural flexibility for rate-of-return carriers. Nonetheless, various commenters still assert that rate-of-return carriers have inflated rates because the Commission is unable to adequately

² See Valor Telecommunications Opposition to Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers, RM-10822, at 6-7 (filed Jan. 16, 2004) ("*Valor Comments*"); Comments of GVNW Consulting, Inc., RM-10822, at 4-5 (filed Jan. 16, 2004).

³ See Comments of The Nebraska Rural Independent Companies, RM-10822, at 6-9 (filed Jan. 16, 2004).

⁴ See *supra* note 20; *FCC Adopts Further Measures to Reform Interstate Access Charge System for Rural Carriers, News Release*, CC Docket No. 00-256 (Feb. 12, 2004).

scrutinize rate-of-return LEC rates.⁵ Furthermore, these commenters contend that “because of the prevailing interpretation of the ‘deemed lawful’ provisions of section 204(a)(3), [rate-of-return] regulation is simply a farce.”⁶ Like Western Wireless, these parties have failed to provide any factual support for these groundless arguments and conclusions.

As established in various comments, there are multiple levels of safeguards to ensure the reasonableness of LEC rates.⁷ No new evidence has been provided illustrating that these mechanisms are insufficient. Instead, like Western Wireless, several commenters reference various instances when LEC rates have been challenged, arguing that there must also be unreasonable rates that go unchallenged.⁸ These examples, however, illustrate that these mechanisms are effective in ensuring reasonable rates.

Commenters’ allegations, as to the insufficiency of the tariff process, are also unfounded. At base, the “deemed lawful” provision of Section 204(a)(3) provides LECs with much needed certainty that has previously been absent from the tariffing process by requiring challenges to tariffed rates to be made prior to them becoming effective.⁹ There is nothing

⁵ Specifically, GCI claims “expense padding and gold-plating is a systemic problem under [rate-of-return] regulation.” Comments of General Communications, Inc., RM-10822, at 7 (filed Jan. 16, 2004) (“*GCI Comments*”). Similarly, Western Wireless suggests that rate-of-return carriers exaggerate the costs of providing service. *Petition* at 25-26. *See also* MCI Comments, RM-10822, at 2 (filed Jan. 16, 2004) (“*MCI Comments*”).

⁶ *GCI Comments* at 7. *See also MCI Comments* at 1-2.

⁷ Joint Comments of Eastern Rural Telecom Association, et al., RM-10822, at 10 (filed Jan. 16, 2004); Comments of John Staurulakis, Inc. on Western Wireless Corporation’s Petition of Rulemaking, RM-10822, at 8 (filed Jan. 16, 2004).

⁸ *See, e.g.*, Comments of the Ad Hoc Telecommunications Users Committee, RM-10822, at 5-9 (filed Jan. 16, 2004) (“*Ad Hoc Comments*”); *Petition* at Attachment A.

⁹ Prior to enactment of this Section, customers were permitted to recover from LECs for charges that were subsequently deemed unreasonable, however, LECs were not permitted to recover for underearnings by recalculating their rates to recover their admittedly valid costs because that would be unlawful retroactive ratemaking. This unbalanced system placed all risk of under-recovery on the LECs and created great uncertainty for LECs by making financial

nefarious about this process. The Commission is free to suspend and investigate the proposed rate, either upon its own initiative or at the request of an interested party.¹⁰ Furthermore, if a tariffed rate becomes effective and a customer subsequently believes the rate to be unreasonable, it may file a complaint against the carrier pursuant to Section 208.¹¹ Similarly, the Commission may investigate tariffed rates and prescribe a reasonable rate if it finds the current rate to be unreasonable.¹² No evidence has been provided that this multi-level process is ineffective in ensuring reasonable rates.¹³ In fact, the various decisions, cited by Western Wireless and various commenters, modifying LECs' rates are indicative that this system is working.

B. The Proposed Incentive Regulation Schemes do not Adequately Address the Unique Concerns of Small to Mid-Sized LECs.

Various commenters, like Western Wireless, propose the establishment of an incentive-based regulatory structure for small to mid-sized carriers, similar to the one currently in place for larger carriers.¹⁴ Valor is not opposed to the adoption of an incentive plan for regulating

commitments difficult to evaluate. The "deemed lawful" provision of Section 204(a)(3) eliminated this disequilibrium.

¹⁰ 47 U.S.C. § 204(a)(1).

¹¹ 47 U.S.C. § 208.

¹² 47 U.S.C. § 205.

¹³ In *ACS of Anchorage v. FCC*, the D.C. Circuit found that the deemed lawful portion of Section 204(a)(3) applies equally to the rates charged by LECs under rate-of-return regulation. *ACS of Anchorage v. FCC*, 190 F.3d 403, 411-412 (D.C. Cir. 2002). Several commenters assert that this interpretation turns rate-of-return regulation into an ineffective enforcement mechanism for ensuring reasonable rates. See *GCI Comments* at 7; *MCI Comments* at 1-2. In making the above determination, however, the court found that the Commission's authority to prescribe rates of return derives only from its authority to ensure just and reasonable rates. *ACS of Anchorage*, 190 F.3d at 411-412. Since the mechanisms outlined above adequately ensure reasonable rates, these commenters' assertions that the application of deemed lawful status to rates of return undermines the purpose of rate regulation are completely unfounded.

¹⁴ See *MCI Comments* at 2-4; *GCI Comments* at 13.

small to mid-sized LECs. However, the incentive regulation plans proposed in this proceeding, by MCI and others, fail to address the inefficiencies inherent in providing service to rural areas. In developing these plans, these commenters made no attempt to design a system based on the realities of providing telecommunications services to rural areas.

Tellingly, MCI proposes time-forgotten measures to which even BOCs are no longer subject. Specifically, MCI urges the Commission to utilize an “X-Factor equal to GDP-PI plus a consumer productivity divided of 0.5 percent,” and adopt a sharing mechanism under which consumers would receive part of the productivity gains achieved under price cap regulation.¹⁵ These are timeworn arguments from a bygone era. Even under price cap regulation, the X-Factor is equal to inflation and sharing has long been eliminated.¹⁶

Even the current incentive-based regime for large carriers will not work for all small to mid-sized carriers, in part because rate-of-return LECs lack the necessary economies of scale in customers and investment to make these measures predictable mechanisms. MCI specifically identified Valor as an example of the principle that the current price cap regime can work for small to mid-sized LECs.¹⁷ As a threshold matter, Valor does not even operate entirely as a price cap LEC.¹⁸ Furthermore, Valor’s experience with price cap regulation has been decidedly

¹⁵ *MCI Comments* at 4.

¹⁶ *See Access Charge Reform, Order on Remand*, 18 FCC Rcd 14976, ¶ 1 (2003) (adopting an X-factor of 6.5% for price cap LECs); *Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262*, 12 FCC Rcd 16642, ¶ 149 (1997).

¹⁷ *MCI Comments* at 4.

¹⁸ Valor’s wholly owned subsidiary, Kerrville Telephone Company, continues to operate as a rate-of-return carrier under a waiver of the FCC’s “all-or-nothing” rule. *Valor Telecommunications, LLC Petition for Waiver of Section 61.41 of the Commission’s Rules, Memorandum Opinion and Order*, 17 FCC Rcd 25544 (2002).

mixed, as evidenced by Valor Texas' continued inability to earn even the statutory minimum interstate return under CALLS.¹⁹

Valor applauds the FCC's recent efforts to actively consider proposals that would provide additional flexibility to rate-of-return carriers. Specifically, the FCC has sought comment in the *MAG Second Notice of Proposed Rulemaking* on specific incentive-based proposals offered by a number of mid-sized and rural carriers.²⁰ Valor supports those efforts and encourages the FCC to act expeditiously to consider and implement their suggestions to provide much needed flexibility to rate-of-return operations. By moving forward with these proposals, the FCC has again moved in the opposite direction of the commenters in the proceeding who wish to impose unneeded intrusive regulatory burdens on rate-of-return carriers.

II. WESTERN WIRELESS' PROPOSAL WILL NOT RESOLVE THE UNDERLYING PROBLEMS WITH THE UNIVERSAL SERVICE FUND.

Universal service is one of the core goals of the Telecommunications Act of 1996.²¹

Many of the proposals suggested by various commenters in this proceeding, however, would

¹⁹ See *Valor Telecommunications of Texas, L.P., Petition for Waiver of the 2003 X-Factor Reductions Under Section 61.45(b)(1)(i) of the Commission's Rules, Order*, 18 FCC Rcd 11523 (2003).

²⁰ *FCC Adopts Further Measures to Reform Interstate Access Charge System for Rural Carriers, News Release*, CC Docket No. 00-256 (Feb. 12, 2004). See also Letter from ALLTEL Communications, Inc., Madison River Communications, LLC, and TDS Telecom, Inc. to Marlene H. Dortch, Secretary, CC Docket Nos. 00-256, 96-45, 98-77, and 98-166 (Mar. 5, 2003) (urging the Commission to allow all rural LECs the option of electing to utilize 47 C.F.R. § 61.39 to establish its applicable access charges); Letter from CenturyTel to Marlene H. Dortch, Secretary, CC Docket Nos. 96-45, 98-77, 98-166, and 00-256 (Dec. 23, 2002) (proposing elimination of the "all-or-nothing" rule and modifications to various other price cap rules).

²¹ Telecommunications Act of 1996, Pub. L. No. 104-104, § 254, 110 Stat. 56 (1996).

undermine this goal.²² Specifically, further capping high-cost support, as proposed by T-Mobile, would be disastrous for rural areas.²³ This proposal implies that because the USF is growing, rural areas are currently receiving sufficient support. Such a conclusion, however, is illogical. The fund has been growing because the Commission has made it a policy of the United States to move from a regulatory structure that encourages implicit subsidies to one that requires all subsidies to be explicit. As this policy is implemented, it is only logical that the USF, *i.e.* the explicit mechanism used to provide rural carriers with support, will grow.²⁴ Furthermore, the USF contribution factor is currently decreasing.²⁵ Therefore, the amount carriers are actually paying into the USF is also decreasing.²⁶ In making this proposition, T-

²² In addition to proposing USF reforms, Ad Hoc accuses Valor of seeking Universal Service funding to support broadband services. *Ad Hoc Comments* at 8. This is a groundless attack because Ad Hoc has mischaracterized the nature and extent of the relief sought by Valor. Valor seeks a waiver of the FCC's parent trap rule to allow the company to receive the amount of Universal Service support it is entitled to based on the actual cost to provide service to its former-GTE Texas properties. *Valor Telecommunications of Texas, L.P., Petition for Waiver of Section 54.305 of the Commission's Rules*, CC Docket No. 96-45 (filed Apr. 30, 2003). Ad Hoc fully concedes that Valor has the right to modernize its "facilities used to provide basic service, to take advantage of more efficient technology." *Ad Hoc Comments* at 8. Since acquiring these properties, Valor has done exactly that - modernize its network to provide quality basic services. Further, Ad Hoc ignores that much of the investment at issue was explicitly required by the state Public Utility Commission. While Valor's new investments do enhance the ability of the company's basic infrastructure to support broadband services, Valor only uses its high-cost support funds to invest in facilities for those services supported by the Universal Service program.

²³ See T-Mobile USA Comments, RM-10822, at 12-14 (filed Jan. 16, 2004) ("*T-Mobile Comments*") (proposing to cap total high-cost USF disbursements).

²⁴ See Comments of The Oklahoma Rural Telephone Companies, RM-10822, at 5, 14 (Jan. 16, 2004).

²⁵ The contribution factor for the first quarter of 2004 will be 8.7 percent while the contribution factor for the fourth quarter of 2003 was 9.2 percent. See *Proposed Fourth Quarter 2003 Universal Service Contribution Factor, Public Notice*, DA 03-2833 (Sept. 5, 2003); *Federal Communications Commission*, Universal Service Home Page at http://www.fcc.gov/wcb/universal_service/ (Jan. 8, 2004).

²⁶ See *T-Mobile Comments* at 12-13.

Mobile also fails to provide any guidance as to how a cap would work or the effect such a cap would have on either new recipients of Universal Service support or the affordability of rates.

Two other proposals are inappropriately raised in this *Petition*: the utilization of auctions and vouchers to determine recipients of USF support.²⁷ The Commission has repeatedly considered and rejected the use of auctions and vouchers.²⁸ T-Mobile has failed to justify why these decisions should be revisited. Moreover, given that these proposals are under consideration in the Commission's review of Eligible Telecommunications Carrier ("ETC") designations,²⁹ the initiation of a new proceeding to consider these proposals is inappropriate.

Ad Hoc's proposal to eliminate the Safety Net Additive, the Mergers and Acquisitions Cap, and the Safety Valve Mechanism is also baseless and unrelated to Western Wireless' *Petition*.³⁰ The FCC adopted these mechanisms as a way to address specific problems with the ability and incentive of LECs to invest in rural infrastructure. Ad Hoc's proposal fails to provide any rationale for why these mechanisms are no longer fulfilling their purpose, and would only further chill rural investment and limit rural carriers' ability to acquire additional rural exchanges without any countervailing benefit. In truth, these measures do not go far enough to bring much needed capital to rural exchanges.³¹

²⁷ *T-Mobile Comments* at 16-18.

²⁸ *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs, Further Notice of Proposed Rulemaking*, 12 FCC Rcd 18514, ¶ 1 (July 18, 1997); *Federal-State Joint Board on Universal Service, Report and Order*, 12 FCC Rcd 8776, ¶¶ 319-325 (1997).

²⁹ *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process, Public Notice*, FCC 03J-1, ¶¶ 19-22 (Feb. 7, 2003).

³⁰ *Ad Hoc Comments* at 10.

³¹ See Letter from the National Telecommunications Cooperative Association, CC Docket Nos. 96-45 and 00-256 (filed Feb. 3, 2004).

Finally, the few commenters that support Western Wireless' *Petition* fail to address a critical problem with the High-Cost Fund: ETC designations.³² These commenters emphasize that the growth in the USF cannot continue and that this growth is due to improper LEC accounting.³³ These commenters provide no factual evidence to support their claims that LECs are purposefully padding their expenses, and yet many of these same commenters advocate that ETCs draw support based on LEC costs. Given that the Commission has recently implemented its policy that all implicit subsidies should be converted into explicit subsidies, it is also only logical that there has been growth in the USF. Therefore, from this point forward, the majority of growth that will occur in the High-Cost Fund will be the result of continuing to grant ETC designations to new entrants. If Western Wireless and other commenters are genuinely concerned about "escalating" growth in the USF, rather than further cap rural LEC funding, it would be more effective to cease granting new ETC authorizations until reforms of that process are implemented.

The Commission has indicated its intent to initiate a broad proceeding that would consider all of the major issues surrounding high-cost support.³⁴ In future proceedings, Valor urges the Commission not to place a straight jacket on its review of the rural mechanism.³⁵ To

³² Other commenters agree with Valor that currently the main concern regarding the USF is ETC designations. *See, e.g.*, Comments of TCA, RM-10822, CC Docket No. 96-45, 2 (Jan. 16, 2004); Joint Comments of Eastern Rural Telecom Association et al., RM-10822, at 7-8 (filed Jan. 16, 2004).

³³ *GCI Comments* at 8; *MCI Comments* at 3.

³⁴ *Federal-State Joint Board on Universal Service, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order*, 18 FCC Rcd 22559, ¶¶ 97-107 (2003). *See also Federal-State Joint Board on Universal Service, Recommended Decision*, 16 FCC Rcd 6153, ¶¶ 13, 21 (2000).

³⁵ The Commission should not prematurely limit its review of the high-cost fund to the establishment of a forward-looking cost USF mechanism for rural carriers or a rural USF mechanism that will eventually be consolidated with the non-rural USF mechanism, as T-Mobile suggests. *T-Mobile Comments* at 9-12.

prepare for that proceeding, the Commission must fully address the effectiveness of the RTF Plan prior to determining or establishing a new plan for rural carriers.³⁶ To do otherwise would result in an outcome that risks undermining the sufficiency of Universal Service support to rural areas.

III. CONCLUSION

Western Wireless' supporters have failed to provide any justification for initiating this duplicative and premature rulemaking. Rate-of-return regulation continues to be the only effective method for adequately regulating small to mid-sized LECs by taking into account the unique circumstances these carriers face. Similarly, the various proposed forward-looking cost mechanisms for distributing Universal Service support to rural areas will seriously inhibit achievement of the Congressional goal to provide all consumers with basic telecommunications services at reasonable and non-discriminatory rates. Valor, therefore, urges the Commission to reject Western Wireless' *Petition*.

Respectfully submitted,

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³⁶ See *Valor Comments* at 5.