

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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

REPLY COMMENTS OF PUERTO RICO TELEPHONE COMPANY

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Table of Contents

I. RATE-OF-RETURN IS A VALID FORM OF REGULATION THAT LEADS TO REASONABLE RATES. 4

II. ANY ALTERNATIVE REGULATION MUST REFLECT REALITIES OF RATE-OF-RETURN CARRIERS..... 6

 A. Any Incentive Plan Must be Optional..... 6

 B. Carriers Should be Allowed to Make the Election on a Study Area by Study Area Basis. 8

III. PRT SHOULD REMAIN UNDER RATE-OF-RETURN REGULATION REGARDLESS OF ITS AFFILIATION WITH VERIZON..... 11

 A. Forcing PRT under CALLS Would Have Significant Competitive and Universal Service Impact. 12

 B. The CALLS Plan Cannot Accommodate PRT..... 15

 C. There is No Harm in PRT Remaining a Rate-of-Return Company..... 16

IV. CONCLUSION..... 18

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REPLY COMMENTS OF PUERTO RICO TELEPHONE COMPANY

The Puerto Rico Telephone Company (“PRT”) hereby files its reply to comments in the above-captioned dockets. The Commission should reject the three major interexchange carrier’s (“IXCs”) attack on the validity of rate-of-return regulation. The IXCs’ claim is based on the rankest form of data manipulation and exaggerated and repudiated regulatory concerns. The economic realities of Puerto Rico and the operational needs of PRT preclude the company from achieving the efficiencies necessary for incentive regulation to work while still maintaining quality service and expanding its network to unserved areas. Any alternative proposal should also reflect the real differences between current price cap and rate-of-return carriers, and the lessons learned under a decade of price cap regulation.

In addition, the Commission should grant PRT’s 1999 waiver request of the All-or-Nothing rule resulting from its affiliation with GTE, now Verizon, or determine that the waiver request is unnecessary if the FCC eliminates the All-or-Nothing rule, which it should do promptly. Forcing PRT under the CALLS plan would be reckless, undermining significant

efforts in Puerto Rico to boost subscriber levels, harming competition in Puerto Rico, and jeopardizing the sufficiency of the CALLS universal service mechanism.

I. RATE-OF-RETURN IS A VALID FORM OF REGULATION THAT LEADS TO REASONABLE RATES.

The IXCs' call for mandatory incentive regulation for all rate-of-return carriers (or for all carriers larger than an arbitrary size) wrongly assumes that rate-of-return regulation is somehow outdated or inherently flawed. The FCC has repeatedly recognized that "[r]ate-of-return regulation has worked well in extending service to rural America."¹ The Commission has further found that rate-of-return carriers "warrant a different approach in some matters;" in part because smaller carriers "generally have higher operating and equipment costs than price cap carriers due to lower subscriber density, smaller exchanges, and limited economies of scale." *MAG Order*, ¶¶ 4-5. It is well-established that rate-of-return regulation sufficiently protects consumers, carrier customers, and carriers with time-tested regulatory checks and need not be hastily eliminated.²

AT&T and MCI's critiques of rate-of-return regulation are unconvincing. AT&T attacks rate-of-return carriers' "high" traffic sensitive rates. AT&T Comments at 13. This wrongly assumes that rates under CALLS and rates for rate-of-return carriers are based on similar costs. Low rates under CALLS (0.55 or 0.95 cents/minute) are possible due to the substantial scope and scale of national price cap carriers. Rate-of-return carriers, on the other hand, often serve higher

¹ *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 19613, ¶ 224 (2001) ("*MAG Order*");

² See Comments of Puerto Rico Telephone Company, RM-10822, at 5 (Jan. 16, 2004). A copy of that filing is included as Attachment A.

cost areas, and smaller exchanges with more limited scale and scope. Because the actual cost to provide services to these areas is higher, access rates are unsurprisingly higher as well. Flash-cut reductions in access charges as contemplated by CALLS and/or the alternative proposals would place great pressure on universal service support mechanisms, and could result in below cost access rates for many rate-of-return carriers.³

Lastly, AT&T and MCI argue that price cap regulation is necessary because the “deemed lawful” provision of Section 204(a)(3) of the Act prevents the FCC from enforcing its refund mechanism for overearnings. AT&T Comments at 8; MCI Comments at 2. AT&T’s assertion is meritless. Congress designed the streamlining tariff procedures to expedite the regulatory review process, ensuring that the FCC identifies any potential problems with proposed tariffs *prior* to their effective date. If the Commission is concerned that a rate-of-return carrier’s tariffs would cause overearnings, the statutory scheme requires it to start an investigation and suspend the tariffs on one day’s notice to prevent the tariffs from obtaining “deemed lawful” status. Access customers can also file petitions seeking investigation if they believe that the rates are targeted too high. AT&T and MCI cannot alter Congress’s clear intent, nor can they disregard the substantial checks on overearning that exist within the tariff review process if rate of returns are too high. In any event, AT&T has raised this issue in its separate petition for forbearance.⁴ It should be addressed (and denied) in that proceeding.

³ Iowa Telecommunications Services, Inc. Tariff FCC No. 1, Transmittal No. 31, Order Terminating Tariff Investigation, 18 FCC Rcd 18907 (2003) (finding that the traffic sensitive access rate of Iowa Telecom, based on forward-looking costs, was higher than the CALLS target rates).

⁴ AT&T Corp. Petition Pursuant to 47 U.S.C. Section 160(c) of the Communications Act for Forbearance from Enforcement of Section 204(a)(3) of the Communications Act, as Amended, WC Docket No. 03-256 (filed Dec. 3, 2003). The record in that proceeding clearly demonstrates that Section 204(a)(3) is a reasonable policy that is achieving the ends Congress

II. ANY ALTERNATIVE REGULATION MUST REFLECT REALITIES OF RATE-OF-RETURN CARRIERS.

CenturyTel and ALLTEL proposed incentive regulation plans based on the operational characteristics of rate-of-return carriers. Both proposals hold promise, and may prove beneficial to some rate-of-return carriers, but any final plan must be optional, available at a study-area level, and free of unnecessary price-cap era regulations.

A. Any Incentive Plan Must be Optional.

The most pivotal component of the plans is optionality.⁵ MCI's suggestions that any carrier with over 100,000 lines (AT&T's similar 50,000 line threshold) should be forced to transition to incentive regulation does not withstand scrutiny. MCI Comments at 2; AT&T Comments at 14. Tellingly, neither carrier provides any data or documentation demonstrating that carriers of this size – regardless of their economics, areas served, line density, operational characteristics, or challenges faced – would have a reasonable opportunity to succeed under incentive regulation.

Puerto Rico is a case in point, where the continued need for traditional rate-of-return regulation is particularly acute despite having a line count above both MCI and AT&T's thresholds. On the mainland, subscribership levels on average remain around 95 percent, while on Puerto Rico levels have dropped below 70 percent island-wide. In Puerto Rico, there are over

desired to achieve. See Comments of Eastern Rural Telecom Assoc., *et al*, WC Docket No. 03-256 (Jan. 30, 2004); Comments of the Verizon Telephone Companies, WC Docket No. 03-256 (Jan. 30, 2004).

⁵ The majority of commenters support optionality for all rate-of-return carriers. See USTA Comments; Verizon Comments; NTCA Comments; ALLTEL, *et al* Comments; NECA Comments.

300 communities in which there is no telecommunications infrastructure, and the cost per loop in these communities can be as high as \$15,000 per loop.⁶ Furthermore, encouraging cost-cutting measures is at odds with the pressing need for PRT to expand and develop its operations to serve high-cost unserved and underserved areas, and modernize its existing facilities to provide mainland-quality service and roll-out new advanced services. As a result, PRT cannot operate successfully under incentive regulation because the ability to succeed under incentive regulation – either traditional price caps or the alternative proposals outlined in the *Notice* – heavily relies on the ability of a carrier to cut costs or grow exchange access demand. This focus may be wholly unrealistic for many rate-of-return carriers under current market conditions. Specifically, incentive regulation does not work well for carriers that need to expand their networks to unserved and underserved areas, modernize plant, and improve service quality with demand that is stagnant or decreasing.

AT&T contends that because a hand-selected group of small price cap carriers have earned acceptable returns under price caps, all rate-of-return carriers with over 50,000 access lines can do the same. AT&T Comments at 14-15. It is ludicrous to suggest that returns of a handful of carriers that have elected price caps prove that other carriers that have not done so would succeed as well. The low rate of elections into price caps itself proves that AT&T's claim is false. Despite AT&T's attempts to manipulate price cap data, in other contexts AT&T has cited to the dangerously low interstate returns of smaller price cap carriers – close in size to rate-of-return carriers – including Citizens Communications CTC5 (4.9 percent) and CenturyTel of

⁶ See generally, Puerto Rico Telephone Company Petition for Clarification and/or Reconsideration, CC Docket No. 96-45 (filed Jan. 14, 2004) (“*Insular Petition*”).

Bell-Herman (4.7 percent).⁷ A comparison of AT&T's selective data sets establishes that smaller and mid-sized carriers' ability to profit under price cap varies widely depending on any number of factors. Thus, there is no proof that incentive regulation would, or could, work for all rate-of-return carriers.

B. Carriers Should be Allowed to Make the Election on a Study Area by Study Area Basis.

The All-or-Nothing rule under price caps has outlived any perceived usefulness, and should be eliminated. The FCC should, therefore, refrain from adopting such a rule in the incentive regulation context for rate-of-return carriers by allowing a study area level election. The Commission explicitly requested proponents of the All-or-Nothing rule to provide concrete examples of the actual harms resulting from the elimination of the rule.⁸ Neither MCI nor AT&T provides any such specific examples, and Sprint concedes that incentive regulation should be available on a study-area level as the FCC tentatively concluded.⁹ The majority of commenters in this proceeding demonstrated that the All-or-Nothing rule is not necessary to guard against cost misallocation, gaming the system, or any other perceived harm. Commenters also provided the Commission with an thorough list of regulatory checks available at the federal and state levels to prevent any such potential misconduct.¹⁰ The Commission should allow study

⁷ AT&T Opposition to Valor's Application for Review, WC Docket No. 03-166, at 7 (July 29, 2003).

⁸ *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 00-256, ¶ 92 (rel. Feb. 26, 2004) ("Order").

⁹ Compare Sprint Comments at 3 to AT&T Comments at 17-19; MCI Comments at 3.

¹⁰ Verizon Comments at 3-4; USTA Comments at 2; NECA Comments at 3-4.

area elections in light of MCI's and AT&T's continued inability to identify a single actual harm associated with the All-or-Nothing rule's elimination, and its own findings that "existing accounting and regulatory processes should permit parties and the Commission to detect cost shifting by the rate-of-return carriers that file cost-based access tariff."¹¹ Moreover, the lack of any allegations of misconduct against any of the handful of carriers operating under waivers of the All-or-Nothing rule further evidences that the rule is unnecessary in the incentive regulation context.¹² This will maximize the number of exchanges under incentive regulation and provide carriers the necessary flexibility to operate their facilities in the most cost-effective manner.

The FCC should also not encumber new incentive regulation for rate-of-return carriers with historical price cap baggage. MCI and AT&T would doom alternative proposals to failure if their punitive additions were incorporated. In fact these conditions have already been rejected or curtailed for price cap carriers.¹³ MCI contends that an X-factor of 6.5 percent should be

¹¹ *Order*, ¶ 92. MCI fails to substantiate its claims that there is a growing risk of improper cost allocation due to the growth of rate-of-return carriers' Internet and CLEC operations, or how current cost allocation and affiliate transaction requirements are insufficient to guard against any alleged misconduct. MCI Comments at 2.

¹² *See generally* Verizon Comments at 5. AT&T and MCI's fallback positions for the All-or-Nothing rule should also be rejected in this context as well. Specifically, AT&T (at 21) contends that all contiguous study areas must remain under the same methodology – either rate-of-return or price caps. However, adjacent study areas may have far different operational characteristics warranting different treatment, and the inability to select the appropriate methodology for all study areas has the effect of maintaining the All-or-Nothing rule for many carriers. AT&T fails to refute the argument that current regulatory checks are sufficient to check any potential problem, regardless of whether study areas are adjacent or not. Similarly, MCI's suggestion (at 4) that no more than 5 percent of a holding company's lines can remain under rate-of-return is arbitrary. There is no benefit to artificially limiting the ability of carriers to determine the amount of lines that remain under rate-of-return.

¹³ Sprint (at 2) suggests that rate-of-return carriers should be subject to price cap regulation, and that no deference should be given to the differences between price cap and rate-of-return carriers. Sprint ignores the FCC's repeated findings that rate-of-return carriers are different and that any solution must reflect the differences between the two sets of carriers.

adopted because there is a “substantial likelihood” that carriers should be able to achieve significant efficiency gains under incentive regulation. MCI Comments at 5. MCI fails to provide *any* tangible support for the contention that an X-factor is warranted or that a 6.5 percent X-factor is justifiable or predicts an achievable level of productivity. In fact, the FCC has repeatedly refused to make price caps mandatory for rate-of-return carriers precisely because it has no method of determining a usable X-factor for smaller carriers.¹⁴ Moreover, the X-factor for most CALLS carriers currently is set at the inflation rate once target rates are achieved.¹⁵ Under the CenturyTel plan, however, access rates would be flash-cut to target rates, eliminating the need for an X-factor. *Order*, ¶ 81. MCI also suggests that the FCC adopt a sharing mechanism. MCI Comments at 5. However, the Commission eliminated the sharing mechanism in 1997 for price cap carriers because it proved to be inefficient and failed to promote competition.¹⁶

Similarly, AT&T’s attacks on special access rates is self-serving and without support. In the *Order*, the FCC provided rate-of-return carriers with additional flexibility to provide special access services in recognition of the competitive forces at work in particular geographic markets. *Order*, ¶ 24. AT&T ignores the FCC’s finding and would impose straight price cap regulation

¹⁴ *MAG Order*, ¶ 219 (“The record, however, is not adequate to determine an X-factor or factors that would be appropriate for all rate-of-return carriers that might elect incentive regulation. This task is particularly difficult because of the diversity of rate-of-return carriers.”).

¹⁵ Under CALLS, the X-factor is *not* a productivity factor; it is a transitional mechanism necessary only to reach the target rates. Further, the Fifth Circuit remanded the FCC’s selection of 6.5 percent as the level of the X-factor. *Access Charge Reform*, Order on Remand, 18 FCC Rcd 14976, ¶¶ 4-10 (2003); *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

¹⁶ *Price Cap Performance Review for Local Exchange Carriers*, Fourth Report and Order, 12 FCC Rcd 16642, ¶¶ 149-151 (1997).

on rate-of-return carriers' pricing of special access with a 6.05 percent X-factor after rates are re-targeted to earn 11.25 percent. AT&T Comments at 26. AT&T self-serving desire to decrease the price it pays for a service should be dismissed out of hand because there is no need to slash special access rates. Re-targeting is unnecessary because rate-of-return carriers' special access rates are already targeted to earn 11.25 percent whenever rates are filed.¹⁷ Customers also have the ability to challenge the validity of any specific rate under the Section 208 complaint procedures. There is thus no basis to re-target or alter current rates even if incentive regulation were adopted.

III. PRT SHOULD REMAIN UNDER RATE-OF-RETURN REGULATION REGARDLESS OF ITS AFFILIATION WITH VERIZON.

PRT became affiliated with GTE in 1999.¹⁸ Under the price cap All-or-Nothing rule, a rate-of-return carrier (PRT) must convert to price cap regulation no later than 12 months after becoming affiliated with a price cap carrier (GTE, now Verizon). 47 C.F.R. § 61.41. PRT requested a waiver of the All-or-Nothing rule on December 10, 1999.¹⁹ Recognizing the impact a forced transition to price caps would have on PRT, the Commission has repeatedly delayed the transition, finding that "PRTC's waiver request raise complex issues regarding local competition,

¹⁷ The Commission uses a carrier's existing interstate rates as a starting point for price cap regulation because those rates were deemed to reflect a "reasonable operation of rate-of-return regulation." *Policy and Rules Concerning Rates for Dominant Carriers*, Order, 5 FCC Rcd 6786, ¶ 232 (1990).

¹⁸ *Puerto Rico Telephone Authority and GTE Holdings (Puerto Rico) LLC, For Consent to Transfer Control of Licenses and Authorization Held by Puerto Rico Telephone Company and Celulares Telefonica, Inc.*, Memorandum Opinion and Order, 14 FCC Rcd 3122 (1999).

¹⁹ Puerto Rico Telephone Company; Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission's Rules, CCB/CPD 99-36 (Dec. 10, 1999) ("*Waiver Request*").

universal service support in Puerto Rico, and operation of the NECA Common Line Pool.”²⁰

Ignoring the Commission’s repeated admonitions as to the dire consequences of forcing PRT under CALLS, MCI suggests that PRT’s conversion to price caps is overdue and that the CALLS plan somehow addressed PRT’s situation. MCI Comments at 6. The Commission should obviate the need for further waivers by eliminating the All-or-Nothing rule, and specifically finding that this applies to previous transactions such as the GTE acquisition of PRT. MCI further failed to establish any harm in maintaining PRT as a rate-of-return property.

A. Forcing PRT under CALLS Would Have Significant Competitive and Universal Service Impact.

Puerto Rico is a very high-cost area due to the insular nature and economic and geographic conditions of the island. Currently, interstate access rates are set considerably below the actual cost to provide service to Puerto Rico because PRT assesses customers the NECA pool’s nationwide average access rate and recoups its additional access costs through ICLS support (formerly Long Term Support), approximately \$70 million in annual support.

MCI demands that PRT shift to price caps, under which PRT would be ineligible to participate in the NECA pool or receive ICLS support. MCI Comments at 6. Moreover, PRT would have to slash its access rates towards the target rates contemplated by the CALLS plan. Without significant universal service support, PRT’s original access rates under price caps would

²⁰ *Puerto Rico Telephone Company Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission’s Rules*, Order, 15 FCC Rcd 9680, ¶ 5 (2000); *Puerto Rico Telephone Company; Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission’s Rules*, Order, 15 FCC Rcd 2785 (2000); *Puerto Rico Telephone Company Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission’s Rules*, Order, 16 FCC Rcd 12343 (2001) (“June 2001 Waiver Order”); *ALLTEL Corporation Petition for Waiver of Section 61.41, et al*, Memorandum Opinion and Order, CCB/CCD No. 99-36, DA 02-888 (rel. Apr. 18, 2002).

be ten times the CALLS target rate.²¹ Stripped of all ICLS support, PRT would require \$139 million in additional universal service support to offset lost access revenues. *See* Attachment B. However, the Commission proposes that new carriers electing price caps would not be eligible to receive revenues from the CALLS IAS fund, and that fund is capped in any event, which would prevent PRT from receiving all of the funds it would need. Comments of Puerto Rico Telephone Company, CC Docket No. 00-256, at 4 (Feb. 14, 2002); *see* Section III.B. below. The Commission explained that there are “serious and complex issues regarding the changes in universal service support facing PRTC if it is required to convert to price cap regulation and regarding impacts on other price cap carriers.” *June 2001 Waiver Order*, ¶ 7.

PRT would be forced to recover at least \$70 million in ICLS support through the imposition of higher implicit charges on interexchange carriers. This runs directly counter to the impetus of the CALLS plan to move the industry towards explicit support mechanisms.²² This universal service upheaval and resulting increase in implicit charges would have a snowball effect on competition in Puerto Rico. First, the Telecommunications Regulatory Board’s efforts to reform intrastate access and reduce implicit subsidies would be jeopardized. Second, the increase in costs to interexchange carriers could force both regional and national providers off the island. Forced to charge rates based on Puerto Rico’s high access costs, regional carriers would be placed at a competitive disadvantage to national carriers that are permitted to offer national rates under Section 254(g) of the Act. Many Puerto Rico or Caribbean-based carriers,

²¹ Puerto Rico Telephone Company, Inc. Supplement to Petition for Waiver, CCB/CPD No. 99-36, at 6-7 (Feb. 12, 2001).

²² What is more, the large portion of the IAS fund that PRT would have to obtain would dramatically reduce the universal service support levels of all other price cap carriers, increasing the chance that those carriers too would have to increase charges on interexchange carriers.

including PRT's long distance affiliate, would, therefore, be unable to compete with AT&T and MCI's substantially lower rates. Moreover, the same increase in cost could result in large IXCs pulling out of the Puerto Rico market as well. Sprint warned four years ago: "carriers like Sprint would have to consider abandoning the Puerto Rico market since Section 254(g) of the Communications Act prevents them from charging de-averaged rates in Puerto Rico that reflects higher costs. Sprint thus agrees with PRTC that such a result would be contrary to the mandate of Section 254(b)(3) of the Communications Act." Comment of Sprint Corporation, CCB/CPD No. 99-36, at 6 (2000).²³ A reduction in carriers serving the island and the creation of a market inhospitable to new entrants is contrary to the goals of the Act.

As described above, a transition to price caps would also place great pressure on PRT to cut costs and streamline operations contrary to the operational realities and consumer needs in of Puerto Rico. *See* Section II.A above. PRT highlighted in its *Waiver Request* on the expected "reduc[tions in] network expansion efforts" and reduced "plant construction and plant improvement budgets." *Waiver Request* at 15. PRT further explained that "[t]he loss of significant universal service support will necessitate dramatic price increases that would be reflected in PRTC's initial rates established under the price cap rules."²⁴ MCI's transparent attempt to cut its own rates fails to recognize the detrimental impact of its request.

²³ The National Exchange Carrier Association has further explained that PRTC's withdrawal from the NECA pools could affect the pool's viability and the operations of the remaining pool participants. *Waiver Request* at 17.

²⁴ *Waiver Request* at 9.

B. The CALLS Plan Cannot Accommodate PRT.

MCI's suggestion that the parties negotiating the CALLS plan incorporated PRT's universal service needs into the negotiations and the Interstate Access Support ("IAS") fund is flat wrong. *See MCI Comments* at 6-7. PRT notes that MCI was never a CALLS participant so it has no reason to know what the parties intended. The Commission has on multiple occasions acknowledged that CALLS did not contemplate the inclusion of new carriers under the plan, and that the inclusion of new members could jeopardize the plan's compliance with the Act's obligation to provide predictable and sufficient universal service support to carriers. *Order*, ¶ 93. The Commission has found explicitly that "[t]he *CALLS Order* did not explicitly address how entry of new carriers into price caps affects distribution of interstate access universal service support. The question is particularly significant here because PRTC could be a large recipient of the [fixed \$650 million IAS fund]. The Commission must carefully weigh PRTC's possible receipt of universal service support under the *CALLS Order*." *June 2001 Waiver Order*, at ¶ 7.²⁵

The CALLS plan included a \$650 million cap on IAS that was based on the anticipated universal service needs of participating price cap carriers.²⁶ The financial impact of shoehorning

²⁵ MCI's reference to Section 54.801(c) of the FCC's rules is inapposite. Even if the CALLS plan contemplated the addition of discrete study areas or small carrier acquisitions, the inclusion of a carrier with the universal service needs of PRT would undermine the integrity of the CALLS plan.

²⁶ See generally *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, Sixth Report and Order, 15 FCC Rcd 12962, ¶¶ 204-205 (2000) ("*CALLS Order*"); Memorandum in Support of the Revised Plan of the Coalition for Affordable Local and Long Distance Service, CC Docket No. 94-1, et al, at 9 (filed Mar. 8, 2000) ("The plan provides a methodology for distributing \$650 million in Interstate Access-related USF to the areas served by each of the participating price cap LECs."). AT&T used a model-based approach to also arrive at \$650 million based on price cap study areas in June 1999, of which PRT was not. Declaration of Joel E. Lubin, CC Docket No. 94-1 (Aug. 18, 1999) ("We estimated the aggregate increment to the explicit federal universal service mechanism *across all price cap LEC study areas* by using the Commission's Synthesis Model with the FCC-published inputs *as of June 2,*

PRT into the IAS mechanism on both Puerto Rico and price cap carriers described above generally underscores the fact that PRT was never considered. Specifically, the injection of PRT's universal service needs into CALLS would result in a greatly reduced IAS fund, which would jeopardize the sufficiency and predictability of the CALLS plan. PRT estimates it would be eligible to receive approximately 21 percent of the total IAS fund. *See* Attachment B. However, the proportional allocation of IAS funds and the fixed cap on the fund also guarantees that PRT would not receive all of its needed universal service funds. 47 C.F.R. § 54.807. The loss of any universal service funds to an area with a total penetration rate below 70 percent is at direct odds with the promise of the Act to provide all Americans with affordable telecommunications services.²⁷

C. There is No Harm in PRT Remaining a Rate-of-Return Company.

Commenters established that the All-or-Nothing rule is not necessary as a general principle to protect against cost misallocation and/or gaming of the system. *See* Section II.B above. Regardless, the Commission highlighted that a different approach may be warranted for carriers “com[ing] together by merger or acquisition.” *Order*, ¶ 94. The affiliation of PRT with Verizon is a case study of why the rule is not warranted, in particular in the case of an acquisition of a rate-of-return property by a price cap carrier.

1999.”) (emphasis added). Many of the CALLS participants did not agree with a model-based approach, but the specific input used by AT&T in its calculations is probative of the intent of the parties.

²⁷ Due to the operation of the FCC's non-rural high-cost model, Puerto Rico has also been stripped of all high-cost loop support, receiving only a minimal amount of hold-harmless support. This loss of approximately \$40 million in annual funding has already impacted PRT's operations and planning. *See Insular Petition*.

The All-or-Nothing rule is designed for instances in which a larger carrier acquires a smaller carrier in whole and subsumes the entity into its operations. That fact pattern is not present in this case because while GTE (now Verizon) became affiliated with PRT in 1999, PRT remained a separate and independently operated entity. Verizon is only one – albeit the largest – shareholder of PRT. Unlike other instances in which the All-or-Nothing rule is invoked, PRT has sizable and powerful minority shareholders including the government of Puerto Rico, and Popular, Inc., the holding company for Banco Popular de Puerto Rico. Neither Popular nor the Puerto Rico government has any incentive to boost Verizon’s corporate profits through improper cost shifting to the detriment of their financial investment and the interests of the people of Puerto Rico. There is thus no risk of cost misallocation based on the structure of PRT’s corporate governance.

In addition, Verizon and PRT have operated under dual regulatory regimes for over 5 years, and no evidence of improper cost shifting has been produced in that time. This real-world experience cannot be underestimated, and MCI did not address this central issue. PRT has also been able to reduce interstate and intrastate access during this period while balancing efforts to expand and modernize its networks.

To the extent Verizon had any incentive to shift costs to PRT, which it does not, current regulatory safeguards are more than sufficient to detect and deter any such action. *See* note 10 above.²⁸ The IXCs’ notion that the size of carrier holding companies effectively cloaks any misconduct is false; the exact opposite is true. The sheer size of Verizon minimizes any risk of

²⁸ The IXCs also underestimate the scrutiny of local regulatory bodies like the Telecommunications Regulatory Board of Puerto Rico, for which PRT is the only incumbent LEC under its jurisdiction. Their audit and review procedures are focused on the operation of PRT.

misconduct because “the difference in magnitude and size between GTE’s domestic operations and PRTC’s operations would make it impossible for GTE to shift a financially meaningful level of costs from its price cap subsidiaries to PRTC.” *Waiver Request* at 20. “[A] cost shift to PRTC of as little as two percent of GTE’s domestic operations telephone plant in service would result in more than a 26 percent increase in PRTC’s” telephone plant in service. *Id.* Those figures actually underestimate the ability to meaningfully shift costs today because the analysis predates the GTE/Bell Atlantic merger, which created a larger pool of costs.

IV. CONCLUSION

The FCC should (1) reaffirm the rate-of-return regulation is a valid form of regulation; (2) provide for alternative regulation for rate-of-return carriers on an optional basis with no unreasonable conditions; (3) eliminate the remaining portions of its All-or-Nothing rule; and (4) make permanent the waiver of the All-or-Nothing rule for PRT, allowing the company to remain under rate-of-return regulation, thereby providing regulatory certainty and stability to Puerto Rico and the company.

Respectfully Submitted,

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May 10, 2004

Before the
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Washington, DC 20554

In the Matter of

Western Wireless Corporation

Petition for Rulemaking to Eliminate Rate-of-
Return Regulation of Incumbent Local
Exchange Carriers

Federal-State Joint Board on Universal Service

RM-10822

CC Docket No. 96-45

COMMENTS OF PUERTO RICO TELEPHONE COMPANY, INC.

I. SUMMARY

The Western Wireless Petition should be summarily rejected as premature. The Commission has recently considered and rejected similar proposals to eliminate rate of return (“ROR”) regulation and to adopt a forward-looking economic costs (“FLEC”) mechanism for high-cost universal service support and access charges. In doing so, the Commission has repeatedly recognized that substantial differences between national and smaller carriers, and rural and non-rural carriers, necessitate different regulatory treatment. Western Wireless has offered no new rationale under which the Commission should depart from its previous decisions to retain ROR regulation for rural carriers, nor has Western Wireless provided any evidence that the inherent shortcomings of FLEC models applied to smaller and rural carriers can be overcome.

Puerto Rico Telephone Company, Inc. (“PRTC”) is a ROR carrier providing service throughout Puerto Rico. A forced transition to incentive-based regulation, designed for large national carriers, would be potentially devastating to PRTC and other smaller and rural carriers

faced with operating in challenging and high-cost areas. Further, incentive-based regulation is inconsistent with the operational realities of Puerto Rico. Puerto Rico's penetration rate is less than 75 percent, far below even the poorest state in the mainland. As a result, PRTC must continue to expand its operations to serve underserved and inaccessible areas, while at the same time modernizing its plant. Yet price cap rules encourage cost-cutting measures to increase efficiency, which create an inherent tension for a growing price cap carrier serving underserved areas like Puerto Rico. A forced transition from NECA pooling and ROR would also strip PRTC of its long-term support funding (available only to ROR carriers). Long-term support is vital to PRTC's continued ability to effectively serve Puerto Rico.

Western Wireless's proposal to alter access charge calculations would also dramatically impact PRTC's ability to maintain affordable long distance services in Puerto Rico. Moreover, the complete failure of the FLEC mechanism used to calculate PRTC's high-cost universal service support to adequately provide for Puerto Rico underscores the inadvisability of Western Wireless's Petition. PRTC, therefore, requests that the Commission deny Western Wireless's Petition.

II. RATE OF RETURN REGULATION OF ACCESS CHARGES IS VALID AND NECESSARY FOR SMALLER CARRIERS

Contrary to Western Wireless's assertion that ROR regulation is somehow "obsolete," support based on ROR regulation remains an accepted (and necessary) tool for regulating smaller carriers. Only two years ago, the Commission explicitly rejected a concerted effort to force all carriers operating under ROR regulation to a form of incentive-based regulation.¹ In fact in that

¹ *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Second Report And Order And Further Notice Of Proposed Rulemaking In CC Docket No. 00-256, 16 FCC Rcd 19613 (2001) ("MAG Order").*

same proceeding, Western Wireless itself demanded that: “the Commission ... expeditiously transition[] them from rate-of-return to incentive-based regulation.”²

The Commission consistently has taken into consideration the significant differences between large national carriers and smaller carriers, and the need to treat each group of carriers individually, differences Western Wireless chooses to ignore. The Commission previously noted that smaller carriers “generally have higher operating and equipment costs than price cap carriers due to lower subscriber density, smaller exchanges, and limited economies of scale. They also rely more heavily on revenues from interstate access charges and universal service support.”³ As a result, the Commission has recognized that the inherent differences between price cap and ROR carriers “warrant a different approach in some matters.”⁴

Indeed, the Commission in 2001 explicitly reaffirmed the validity of ROR regulation. In the *MAG Order*, the Commission adopted certain modifications to ROR, consistent with “the specific challenges faced by small local telephone companies serving rural and high-cost areas.”⁵ In doing so, the Commission acknowledged that “[r]ate-of-return regulation has worked well in extending service to rural America.”⁶

² Comments of the Competitive Universal Service Coalition, CC Docket No. 00-256 at 3-5 (filed Feb. 14, 2002); *see also* Reply Comments of the Competitive Universal Service Coalition, CC Docket No. 96-45 (filed Aug. 28, 2001) (listing Coalition members including Western Wireless Corporation).

³ *MAG Order* at ¶ 4.

⁴ *Id.*, at ¶ 5.

⁵ *Id.*, at ¶ 12.

⁶ *MAG Order* at ¶ 224.

Contrary to Western Wireless’s claims, ROR regulation is not rife with abuse.⁷ Western Wireless provides six case studies that purportedly establish “extensive incidents” of ROR misconduct.⁸ As a threshold matter, many of the “incidents” cannot be fairly characterized as carrier misconduct. Carriers and regulators routinely negotiate and confer as to the proper cost inputs in ROR ratemakings and related proceedings, and carriers and regulators at times disagree as to the proper types (or amount) of costs to be included. For instance, Western Wireless cites to a Washington state proceeding as one of its examples of abusive carrier behavior. In that case, Western Wireless highlights that U S West and the state regulator had different interpretations as to the inclusion of “certain R&D costs paid to affiliates” and “corporate image advertising costs” in its rate base – far from abusive behavior.⁹

Further, Western Wireless’s bizarrely includes in its six examples of ROR “abuse,” cost allocation disagreements between regulators and carriers regulated under alternative forms of regulation, not ROR.¹⁰ Nonetheless, to the extent that any of the “misconduct” cited to by Western Wireless is an actual example of abuse by ROR carriers, the fact that regulators “thoroughly scrutinized” the carrier’s cost studies demonstrate that current enforcement mechanisms are more than adequate to protect against any potential carrier transgressions. Western Wireless also freely acknowledges that ROR carriers are subject to multiple levels of oversight with independent auditing power.¹¹

⁷ *Petition* at 26-28.

⁸ Attachment A to *Petition*.

⁹ *Id.*, at 9.

¹⁰ *Id.*, at 10 (referencing Oregon Case Study for a carrier operating under an “Alternative Form of Regulation”).

¹¹ *Petition* at 26.

Western Wireless's rhetoric is also misleading. Western Wireless focuses on decisions applicable only to large ILECs, while ignoring language in the same orders recognizing that the particular needs of smaller, rural, and high-cost carriers warrant a different regulatory approach. Further, the study by the National Regulatory Research Institute on state regulation of LECs that Western Wireless cites in the Petition as support for eliminating ROR proves the opposite.¹² While Western Wireless is correct that most, but not all, states have moved to an incentive-based approach for large national carriers, the study concludes that many states continue to use ROR to regulate smaller, rural and high-cost ILECs, including PRTC.¹³ Western Wireless's allegations that ROR is obsolete and that the FCC and the majority of states share an "aversion" to ROR are false.

III. FORWARD-LOOKING COST MODELS ARE DEMONSTRABLY UNSUITABLE FOR DETERMINING UNIVERSAL SERVICE HIGH-COST SUPPORT FOR SMALLER, RURAL, AND INSULAR CARRIERS

At base, universal service support promotes access to basic telecommunications service in areas where the cost of such service otherwise might be prohibitively expensive.¹⁴ The Rural Task Force recommended against the use of the Commission's forward-looking mechanism for non-rural carriers to calculate high-cost support for rural carriers because that model was shown to be unsuitable to guaranteeing predictable and sufficient universal service support to rural high-

¹² *Petition*, at 13, fn. 13.

¹³ See National Regulatory Research Institute, Retail Regulation of Local Telecommunications Providers (as of April 2002), available at <http://www.nrri.ohio-state.edu/programs/markets/pdf/reg-regime-adoption-by-state-map.pdf>.

¹⁴ See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report And Order, Twenty-second Order on Reconsideration, and Further Notice Of Proposed Rulemaking in CC Docket No. 00-256, 16 FCC Rcd 11244, ¶ 13 (2001) ("*RTF Order*");

cost areas as required by the Act.¹⁵ Instead, the Commission adopted a modified version of the existing high-cost loop support mechanism based on carrier's actual costs to provide service for at least a five-year period.¹⁶

Western Wireless selectively cites to general FCC pronouncements in support of forward-looking cost mechanisms, yet the Commission has repeatedly held the use of actual costs to provide access charge and universal service is a "reasonable and prudent approach."¹⁷ More importantly, the Commission has repeatedly found that the use of a FLEC mechanism "is not feasible at this time" for all carriers.¹⁸ The Commission over six years ago clearly established that "rural carriers will begin receiving support pursuant to support mechanisms incorporating forward-looking economic cost principles **only** when we have sufficient validation that forward-looking support mechanisms for rural carriers produce results that are sufficient and predictable."¹⁹

Western Wireless's Petition presupposes that the Commission has already decided to force all carriers to FLEC-based support upon the expiration of the five-year period, yet Western Wireless has failed to provide any new modeling or cost input information to suggest that the inherent deficiencies of FLEC models can now be overcome. Western Wireless has simply repackaged into its Petition its arguments that the FCC has already rejected in prior

¹⁵ *Id.*, at ¶ 18.

¹⁶ *Id.*, at ¶ 17.

¹⁷ *MAG Order* at ¶ 129.

¹⁸ *Id.*

¹⁹ *Federal State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776 ¶ 252 (1997) (emphasis added).

rulemakings.²⁰ Western Wireless has offered no substantiation that a FLEC mechanism could produce sufficient and predictable universal service support to smaller and rural carriers. In the absence of any new evidence that the existing mechanism is broken for small and rural carriers, there is no justification for the Commission to start a new proceeding to “fix” it.

The danger of hasty application of FLEC methodology on smaller and rural carriers is exemplified by PRTC’s experience under the non-rural universal service support mechanism. PRTC serves all of Puerto Rico, including the rural and mountainous areas, yet is the only high-cost insular carrier not provided for under the rural high-cost support mechanism. As such, when the Commission established its FLEC-based non-rural high-cost support mechanism, PRTC’s high-cost universal service support was reduced from over \$50 million per year to no support at all (ignoring phased-down hold harmless support), as the model grossly underestimated PRTC’s actual cost to provide service. The Rural Task Force accurately predicted that the FLEC models would not accurately reflect smaller carriers’ costs.²¹ PRTC’s ability to invest in infrastructure improvements and modernization has been impeded due to the elimination of all high-cost support. Western Wireless’s request would put rural carriers in the same precarious position as PRTC—jeopardizing the Commission’s universal service mandate.

Even worse, Western Wireless also attempts to strip smaller and rural carriers of their access charge revenues by forcing access charge calculation to a FLEC model as well. As described above, the inability of a FLEC model to properly reflect the actual costs of smaller and rural carriers risks under-recovery of carriers’ costs and injects unpredictability into the access

²⁰ Western Wireless, Ex Parte Presentation, CC Docket No. 96-45 (Apr. 20, 1999) (“The delay in implementing a forward-looking cost model for rural telephone company territories severely disadvantages competitive carriers.”).

²¹ See *Federal-State Joint Board on Universal Service*, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, 16 FCC Rcd 6165 (2000).

charge regime, endangering the ability of carriers to maintain and modernize their networks. FLEC-based access charges would likely result in a stark reduction in interstate support, which, in turn, would require higher retail rates to the detriment of consumers.

Further, by attempting to call into question the propriety of smaller and rural carriers' universal service and access charge regimes prior to the conclusion of the five-year period, Western Wireless is attempting to chill further investment in ROR and rural carriers for its own competitive advantage. Western Wireless cannot be allowed to use the Commission's procedures and resources to create regulatory uncertainty, when none properly exists, thereby directly undermining the underlying premise of the FCC's decision to establish a five-year period of regulatory certainty. There is simply no basis to impose an unworkable FLEC model on rural and smaller carriers.

IV. THERE IS NO JUSTIFICATION TO BEGINNING A NEW PROCEEDING ON ISSUES THAT MUST BE FIRST RESOLVED IN OTHER ACTIVE PROCEEDINGS

Western Wireless attempts to hijack the Commission's decisionmaking process and shoehorn issues into a proceeding of its own design, ignoring that these issues are properly at issue in more appropriate proceedings, which Western Wireless admits are "closely related."²² Conclusion of those related proceedings is a necessary precondition to action, or even consideration, of Western Wireless's requested relief. These proceedings will serve as the key building blocks for the Commission's review of the issues Western Wireless attempts to prematurely address.

²² *Petition* at 6.

For instance, the Commission has been studying for over two years its access charge regime in the *Intercarrier Compensation* proceeding.²³ Likewise, the Joint Board will soon begin its comprehensive review of non-rural and rural high cost universal service support.²⁴ The Commission is also currently assessing the possibility of extending forward-looking cost pricing to smaller carriers in the pending TELRIC proceeding.²⁵ Finally, the FCC is addressing the potential use of incentive regulation for smaller carriers in the MAG proceeding.

Thus, consideration of Western Wireless's request would be counterproductive and wasteful of Commission resources at this time.²⁶ There is also no basis to interject Western Wireless's self-serving arguments and proposals into those ongoing proceedings. The Commission has recently reaffirmed that it "must and will initiate a proceeding to address the appropriate intrastate high-cost support mechanism for rural carriers after the Rural Task Force plan expires."²⁷ That proceeding will be the proper forum for Western Wireless to present its proposals to the Commission. There is, however, no basis for the Commission's consideration of these issues to be framed by Western Wireless's biased and inaccurate characterization of ROR carriers and embedded-cost support mechanisms.

²³ *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, 16 FCC Rcd 9610, ¶ 1 (2001) ("*Intercarrier Compensation NPRM*").

²⁴ *See RTF Order; Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order in CC Docket No. 96-45, FCC 03-249 (Oct. 27, 2003) ("*Remand Order*").

²⁵ *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd 18945 (2003) ("*TELRIC NPRM*").

²⁶ *See* 47 C.F.R. § 1.401(e).

²⁷ *Remand Order* at ¶ 107.

V. CONCLUSION

The Commission should deny Western Wireless's Petition.

RESPECTFULLY SUBMITTED,

By: /s/ Bradley K. Gillen

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January 16, 2004

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Comments of Puerto Rico Telephone Company, Inc. was sent by first-class mail, postage prepaid, this 16th day of January 2004, to the following:

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PRTC Interstate CMT & ICLS

			PRTC	PRCC	Total
A	CMT				
1	CL Rev Req	2002 Cost Studies	\$ 124,707,973	\$ 20,488,597	\$ 153,234,044
2	TS shift from LS to CL	MAG filing 12/17/01	\$ 4,449,703	\$ 576,008	\$ 5,025,711
3	Interstate Mktg Exp				
a	Already In CL	2002 Cost Studies	\$ 1,580,661	\$ 324,431	\$ 1,905,092
b	Total Interstate	2002 Cost Studies	\$ 2,392,780	\$ 391,185	\$ 2,783,965
c	Reassign to CL	3b-3a	\$ 812,119	\$ 66,754	\$ 878,873
4	TIC Rev allocated to CL	MAG 2002 Cost Studies	\$ 14,202,450	\$ 1,894,723	\$ 16,097,173
5	Total CMT		\$ 144,172,245	\$ 23,026,082	\$ 175,235,801
6	USF Loops 12/31/02				
a	Res+SLB		1,025,547	172,608	1,198,155
b	MLB		61,266	4,718	65,984
c	Total	6a+6b	1,086,813	177,326	1,264,139
7	CMT per Line	6c/L5/12	\$ 11.05	\$ 10.82	\$ 11.55
8	MMUSS Res&SLB				
a	MMUSS Level		\$ 7.00	\$ 7.00	\$ 7.00
b	MMUSS less CMT		\$ 4.05	\$ 3.82	\$ 4.55
c	Res&SLB MMUSS		\$ 49,898,996	\$ 7,914,370	\$ 65,444,035
8	MMUSS MLB				
a	MMUSS Level		\$ 9.20	\$ 9.20	\$ 9.20
b	MMUSS less CMT		\$ 1.85	\$ 1.62	\$ 2.35
c	MLB MMUSS		\$ 1,363,535	\$ 91,773	\$ 1,862,113
9	MMUSS Total				
a	Res&SLB MMUSS		\$ 49,898,996	\$ 7,914,370	\$ 65,444,035
b	MLB MMUSS		\$ 1,363,535	\$ 91,773	\$ 1,862,113
c	Total MMUSS		\$ 51,262,531	\$ 8,006,143	\$ 67,306,148
B	ICLS	NECA ICLS Projection	\$ 63,621,270	\$ 8,366,179	\$ 71,987,449
C	Total	A.9.c+B	\$ 114,883,801	\$ 16,372,322	\$ 139,293,597
D	% of IAS Cap	C/IAS Cap			21.4%
D	% of USF needs	A.9.c/C			48.3%