Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Federal-State Joint Board on Universal Service Seeks Comment On Certain of the Commission's Rules Relating to High-Cost Universal Service Support	)	

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REPLY COMMENTS
of the
ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

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SUMMARY

High-cost support for all rural telephone companies, as defined in the 1996 Act, should continue to be based on their study area average embedded costs. Similarly, support for CETCs in rural service areas should be based on their own embedded costs.

Numerous commenters agree that the complete statutory definition of "rural telephone company" should continue to be used for determining which carriers are "rural" for high-cost universal service purposes. The "rural telephone company" definition is not over-inclusive since the rural high-cost mechanism, by its nature, incorporates all of the factors that determine whether or not an area is high-cost for a rural carrier to serve. On the other hand, narrowing the definition of "rural" would jeopardize the ability of the affected carriers to continue providing quality, modern services throughout their territories.

The majority of commenters agree that embedded costs should be retained as the basis of support for rural ILECs. The use of embedded costs has encouraged prudent investment in rural infrastructure because carriers know that the support they receive will directly relate to the actual costs they incur in the provision of the supported services. Conversely, the use of FLEC estimates would fail to provide rural ILECs with specific, predictable and sufficient support, dampening their incentive to invest in their networks. Furthermore, there have been no known improvements to FLEC models that would overcome the accuracy problems detailed by the Rural Task Force.

The Joint Board should reject the suggestion that support be based on the forward-looking cost of the "most efficient" technology. This fails to take into consideration the qualitative differences in the services provided through each technology

as well as the way in which consumers perceive and use the technologies. Also troublesome is the proposal to base support for rural, rate-of-return ILECs on the costs of price cap ILECs. It makes no sense to use the costs of a fundamentally different price cap carrier as a proxy for what a rural, rate-of-return carrier's costs "ought to be." In addition, an embedded cost-based mechanism does not encourage rural ILECs to operate inefficiently. The significant competitive threats facing rural ILECs force them to operate and invest in a highly judicious manner.

Numerous commenters advocate basing high-cost support for CETCs in rural service areas on their own embedded costs. These commenters agree that providing CETCs with the rural ILEC's identical per-line support amount is inconsistent with the language of Section 254, is not competitively neutral, and is causing the Fund to grow unnecessarily at the expense of ratepayers nationwide.

Basing support on each ETC's own embedded costs is not discriminatory. Rural ILECs have far more regulatory requirements imposed on them than CETCs. In a competitive environment in which carriers are so differently situated, it does not adhere to the principle of competitive neutrality to provide all ETCs serving an area with the same per-line support amount. Furthermore, the contention that basing support on each carrier's own costs will eliminate efficiency incentives fails to recognize that high-cost support is no carrier's sole source of revenue. All ETCs operating in today's highly competitive marketplace have ample incentive to strive to improve their efficiency in order to create value for consumers.

Numerous parties are supportive of the interim "safe harbor" plan filed by the Rural Telecommunications Associations in the FCC's proceeding on the Joint Board's

Portability Recommended Decision. Adoption of this plan as an interim mechanism would enable the Commission to immediately get the excessive growth in the High-Cost program under control while it develops equivalent cost reporting rules for CETCs.

The existing support calculation methodology for rural ILECs should essentially be retained. In particular, rural ILECs should continue to receive support based on their total network costs. Freezing per-line support in rural service areas would cut the tie between rural ILECs' support and their total network costs, thereby discouraging investment in network facilities and placing upward pressure on end-user rates.

In addition, corporate operations expenses should continue to be supported by the high-cost support mechanisms. Carriers incur operating costs and these costs are every bit as important to providing universal service as the loops and switches that transport telecommunications traffic.

Numerous commenters agree that rural carriers' high-cost support should not be based on statewide average costs. The use of statewide average costs would unfairly leave many high-cost rural carriers ineligible to receive any federal funding due to the unrelated costs of much larger carriers operating in the state. This would seriously threaten these carriers' continued ability to provide affordable, high-quality services to rural consumers.

Finally, the cap on the high-cost loop support mechanism should be lifted. The cap is an arbitrary impediment to the sufficiency of cost-based support. Removal of the cap will assist all ETCs in rural service areas in satisfying the universal service goals of Section 254.

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REPLY COMMENTS
of the
ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

I. INTRODUCTION

The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) hereby submits these reply comments in response to comments filed on the Federal-State Joint Board on Universal Service's (Joint Board) Public Notice, released August 16, 2004.[1] The Public Notice seeks comment on issues relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the Federal Communication Commission's (FCC, Commission) Rural Task Force Order.[2]

[1] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, 19 FCC Rcd 16083 (2004) (Public Notice).
[2] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (2001) (Rural Task Force Order).

OPASTCO is a national trade association representing over 560 small incumbent local exchange carriers (ILECs) serving rural areas of the United States. Its members, which include both commercial companies and cooperatives, together serve more than 3.5 million customers. All OPASTCO members are rural telephone companies as defined in 47 U.S.C. §153(37). OPASTCO members offer a wide array of communications services to rural consumers in addition to the traditional telephone services they provide as ILECs. These include dial-up Internet access, high-speed and advanced services, mobile wireless services, competitive local exchange service, long distance resale, and video services.

OPASTCO is in agreement with the many commenters who state that the statutory definition of "rural telephone company" should continue to be used for determining which carriers are "rural" for high-cost universal service purposes and that rural ILECs' support should continue to be based on their study area average embedded costs. The rural high-cost mechanisms have been instrumental to rural ILECs' provision of high-quality, modern services to rural consumers at affordable rates. Thus, any significant changes to the High-Cost program for rural ILECs would only serve to threaten its tremendous level of success.

OPASTCO is also in agreement with the numerous commenters that advocate eliminating the identical support rule and basing support for competitive eligible telecommunications carriers (CETCs) in rural service areas on their own embedded costs. This would address the root cause of the excessive growth occurring in the rural High-Cost program as well as the lack of parity that presently exists in the basis of support for rural ILECs and CETCs. At the same time, it would ensure that all ETCs in rural service

areas have sufficient support to achieve the universal service objectives of the Telecommunications Act of 1996 (1996 Act, the Act).

II. THE RECORD STRONGLY SUPPORTS CONTINUED USE OF THE COMPLETE STATUTORY DEFINITION OF "RURAL TELEPHONE COMPANY" FOR DETERMINING WHICH CARRIERS ARE "RURAL" FOR HIGH-COST UNIVERSAL SERVICE PURPOSES

A substantial majority of the parties commenting on the definition of "rural" for high-cost universal service purposes agree with OPASTCO that the complete statutory definition of "rural telephone company"[3] should continue to be utilized.[4] The existing statutory definition of "rural telephone company" is administratively simple to use and is effective in targeting the proper amount of support to carriers serving predominantly rural and high-cost areas. Commenters recognize that subjecting a subset of rural telephone companies to the non-rural High-Cost program would, in many instances, cause these carriers to receive insufficient support. This would hinder continued infrastructure investment in these rural areas and threaten the provision of affordable and "reasonably comparable" services and rates to rural consumers.

A few commenters recommend truncating the definition of "rural" for high-cost universal service purposes in some fashion.[5] These parties generally assert that the statutory definition of "rural telephone company" is over-inclusive, allowing some rural

[3] 47 U.S.C. §153(37).

[4] *For example,* United States Telecom Association (USTA), pp. 6-7; National Telecommunications Cooperative Association (NTCA), pp. 4-5; Independent Telephone and Telecommunications Alliance (ITTA), pp. 17-19; Western Telecommunications Alliance (Western Alliance), pp. 20-22; Rural Independent Competitive Alliance (RICA), pp. 7-9; Coalition of State Telecommunications Associations and Rural Telephone Companies (Coalition), pp. 6-11; Alaska Telephone Association (ATA), pp. 7-8; GVNW Consulting, Inc. (GVNW), p. 5; John Staurulakis, Inc. (JSI), pp. 9-11; ICORE Companies (ICORE), pp. 3-4; Interstate Telecom Consulting, Inc. (ITCI), pp. 15-17; Alexicon Telecommunications Consulting (Alexicon), pp. 13-14; FairPoint Communications (FairPoint), pp. 15-16; TDS Telecommunications Corp. (TDS Telecom), pp. 14-16; ALLTEL Corporation (ALLTEL), pp. 4-6; CenturyTel, Inc. (CenturyTel), pp. 13-17; Sandwich Isles Communications, Inc. (SIC), pp. 12-13; Frontier and Citizens ILECs (Frontier), p. 6; Iowa Telecommunications Services, Inc. (Iowa Telecom), p. 11.

[5] National Association of State Utility Consumer Advocates (NASUCA), pp. 9-19; Nextel Communications Inc. (Nextel), pp. 15-16; Dobson Cellular Systems, Inc. (Dobson), pp. 4-6; Verizon, pp. 8-14.

carriers with characteristics more similar to those of non-rural companies to be eligible for the rural High-Cost program. But what these commenters fail to recognize is that just because a carrier is "rural" for high-cost universal service purposes does not necessarily mean that it receives high-cost support. Under the rural High-Cost program, a rural ILEC receives high-cost loop support (HCLS) only to the extent that its embedded costs exceed certain cost benchmarks. Numerous commenters correctly explain that if a rural carrier has certain characteristics that help to lower its costs, such as economies of scale or a more densely populated service territory, it will automatically factor into the amount of support that it receives, if any, under the rural program.

In its comments, NASUCA states that "the presumption should be that, unless a larger rural carrier has high costs, it does not have a need for federal support..."[6] NASUCA contends that a proper definition of "rural" would ensure that only companies with high costs would receive federal support.[7] But this is precisely what occurs under the existing rural program and ironically, data provided in NASUCA's comments demonstrates this point.

The table on page 24 of NASUCA's comments shows that rural carrier study areas with more than 50,000 loops receive just 23 percent of rural high-cost support, even though these study areas account for approximately 65 percent of all rural carrier working loops. On the other hand, rural study areas with less than 50,000 loops, which account for the remaining 35 percent of rural carrier working loops, receive 77 percent of all rural high-cost support.

[6] NASUCA, p. 14.
[7] *Id.*, p. 4.

An analysis of the Universal Service Administrative Company's (USAC) most recent fund size projections derives results consistent with the data provided by NASUCA. Of all the universal service support projected to be received by rural ILECs during 1st quarter 2005 ($621.6 million), less than 10 percent will be received by ILEC study areas with 100,000 access lines or more ($60.8 million). Moreover, less than 22 percent of rural ILEC support will be received by ILEC study areas with 50,000 access lines or more ($134.6 million).[8]

The current USAC data, along with the data provided by NASUCA, conclusively demonstrates two things. First, the overwhelming majority of rural high-cost support is going to the smallest ILEC study areas. Second, under an embedded cost-based system of support, to the extent that larger rural carriers have lower per-line costs, the mechanism appropriately provides them with less support, if any at all. Thus, the "rural telephone company" definition cannot be over-inclusive since the rural mechanism, by its nature, incorporates all of the factors that determine whether or not an area is high cost for a rural carrier to serve.

While there is no chance of any rural ILEC receiving unjustified high-cost support if the statutory definition of "rural telephone company" continues to be used, narrowing the definition of "rural" for high-cost universal service purposes poses great risk to the customers of the affected carriers. Under a narrowed definition, rural ILECs serving high-cost areas that are arbitrarily deemed "non-rural" for universal service purposes would likely receive insufficient support to maintain, and make timely upgrades to, their

[8] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2005*, Appendices HC01, HC05, HC17 (Nov. 2, 2004).

network infrastructure. This would hamstring these carriers' ability to continue providing quality, modern services throughout their territories.

To address the loss of support to those rural telephone companies shifted to the non-rural High-Cost program, Verizon suggests that affected carriers be permitted to recover the difference in support directly from their end users.[9] However, Verizon fails to acknowledge that its proposal would, in many instances, produce end-user rates that are unaffordable and/or not reasonably comparable to the rates offered in urban areas. As ALLTEL states, "[t]he goals of Section 254 would not be served by requiring subscribers in high cost areas to meet ever increasing portions of the true cost of their service by depriving carriers serving those areas of universal service support simply through definitional artifice."[10]

A few wireless carrier interests propose the eventual adoption of a unified high-cost support mechanism for all ETCs based on forward looking economic cost (FLEC) estimates, with no differentiation in treatment between rural and non-rural carriers.[11] However, JSI is correct in saying that "[n]o evidence suggests that there is a fundamental incompatibility between embedded cost calculations for rural ILECs and another calculation method for non-rural carriers."[12]

The type of ILEC serving a rural area is highly relevant in determining the appropriate high-cost support mechanism. Small and mid-size rural telephone companies serving mostly or exclusively rural territory have unique characteristics that set them

[9] Verizon, pp. 13-14.
[10] ALLTEL, p. 6.
[11] CTIA – The Wireless Association (CTIA), pp. 17-19; Western Wireless Corporation (Western Wireless), pp. 32-34; Nextel, p. 12.
[12] JSI, p. 14.

apart from large carriers serving predominantly urban areas of the country. This has been recognized by Congress, the Rural Task Force, the Joint Board and the FCC.

Had Congress believed that the same policies and regulations should be applied to all ILECs serving rural areas, it would never have bothered to establish a "rural telephone company" definition or crafted special provisions for the designation of additional ETCs in these carriers' service areas.[13] In addition, the Rural Task Force, in its recommendation to the Joint Board, found that "[t]he evidentiary record [it] assembled ...clearly supports a conclusion that a 'one-size-fits-all' national universal service policy is unlikely to be successful in fulfilling the national universal service principles contained in the 1996 Act."[14] Furthermore, the FCC has acknowledged that "[i]n implementing the universal service provisions of the 1996 Act, the Joint Board and the Commission have consistently recognized that rural carriers face diverse circumstances and that 'one size does not fit all' in considering universal service support mechanisms that are appropriate for rural carriers."[15]

In short, the Act's "rural telephone company" definition works well for determining which carriers are "rural" for high-cost universal service purposes and the Joint Board should not expend its limited time and resources making arbitrary changes to it. Instead, the Joint Board should focus its attention on reforming the basis of support for CETCs, so that like rural ILECs, these carriers will receive support only when it is justified by their actual costs.

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[13] 47 U.S.C. §214(e)(2).

[14] *Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 16 FCC Rcd 6165, 6177 (2000) (Rural Task Force Recommendation). It is worth noting that Western Wireless's Vice President of Regulatory Affairs was a member of the Rural Task Force and a signatory to its recommendation.

[15] Rural Task Force Order, 16 FCC Rcd 11247, ¶4 (2001).

III. THE MAJORITY OF COMMENTERS ADVOCATE THE CONTINUED USE OF EMBEDDED COSTS AS THE BASIS OF SUPPORT FOR RURAL ILECS AND REJECT THE USE OF FLEC ESTIMATES

The majority of commenters agree with OPASTCO that embedded costs should be retained as the basis of support for rural ILECs.[16] Commenters explain how the use of embedded costs has been a resounding success in enabling rural ILECs to achieve the Act's universal service objectives. Under an embedded cost-based mechanism, rural carriers know that the high-cost support they receive will directly relate to the actual costs they incur in the provision of the supported services. It is this predictability and specificity to each rural carrier's costs that has encouraged prudent investment in rural infrastructure, including the multi-functional facilities necessary for the provision of advanced services.

Conversely, the use of FLEC estimates as the basis of support for rural ILECs would fail to comport with the 1996 Act's universal service principles and objectives. FLEC estimates are based on hypothetical, perfectly efficient "least-cost" networks. They are not related to the actual costs carriers incur as they gradually make upgrades to their systems. Thus, FLEC-based support would call into question whether funding will be sufficient to enable full recovery of the cost of network facilities, even though those investments were efficient and prudent at the time they were made. FLEC-based support would also fail to enable rural ILECs to comfortably predict how much support they will receive, since models can be altered at any time. Without specific, predictable and

[16] *For example,* Regulatory Commission of Alaska (RCA), pp. 12-14; National Exchange Carrier Association (NECA), pp. 13-16; Rural Oklahoma Telecommunications Coalition (ROTC), pp. 7-8; Texas Statewide Telephone Cooperative, Inc. (TSTCI), pp. 3-11; Plains Rural Independent Companies (Plains Companies), pp. 2-5; Tri County Telephone Association, Inc. (TCT), pp. 7-9; Fred Williamson and Associates, Inc. (FW&A), pp. 9-18; Home Telephone Company, Inc. and PBT Telecom, Inc. (Home Telephone), pp. 5-6; USTA, pp. 9-13; NTCA, pp. 5-6; ITTA, pp. 22-29; Western Alliance, pp. 10-20; RICA, pp. 6-7; Coalition, p. 11; ATA, pp. 9-17; ITCI, pp. 8-15; JSI, pp. 12-14; ICORE, pp. 4-6; Alexicon, pp. 7-13; FairPoint, pp. 9-15; TDS Telecom, pp. 4-11; SIC, pp. 16-18.

sufficient support that provides the opportunity for cost recovery and a return on investment, "most investment by rural telephone companies...[would] slow to a crawl, or cease entirely."[17] This includes investment in the multi-use facilities needed to deploy advanced services to greater numbers of rural consumers.

Furthermore, even if FLEC estimates were somehow appropriate as the basis of support for rural ILECs, commenters explain that there have been no known improvements to FLEC models that would overcome the accuracy problems detailed by the Rural Task Force. It is highly unlikely that a model could be developed that would provide reasonable estimates of FLEC for the diversity of rural telephone companies and their operating environments. As the Rural Task Force explained in their fourth white paper, rural ILECs do not operate on anywhere near the scale of the Bell companies, making it impossible for them to "average out" a FLEC model's miscalculations at the wire center level.[18] Moreover, unlike the non-rural carriers, many rural ILECs rely on high-cost support for a significant portion of their cost recovery. Consequently, a model's inability to correctly calculate the cost of providing service to a high-cost area could seriously hinder a rural ILEC's ability to continue offering high-quality, modern services at affordable rates.

Even NASUCA acknowledges that the FCC's Synthesis Model would have to be improved before it could be applied to rural carriers. It recommends that the cost of such improvements "be considered as universal service costs and be funded by the Universal

[17] Western Alliance, p. 18.

[18] *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, Rural Task Force White Paper 4, p. 7 (Sept. 2000) ("The 'Law of Large Numbers' suggests that for the RBOCs, those wire centers where the support results are too high will tend to offset those which are too low, resulting in a reasonable overall result. This is not the case for many Rural Carriers who serve only a few wire centers, or in some cases, a single wire center.").

Service Fund."[19] Certainly, it would not be an "efficient" use of universal service support, not to mention the FCC's resources, to attempt to modify a FLEC model for rural carriers, which would almost certainly jeopardize the provision of quality services at affordable rates in some high-cost rural service areas. As TDS Telecom states, "[w]hile the likelihood of adopting the right forward-looking rural cost model is slim, the risk of adopting the wrong model is great."[20] The use of embedded costs as the basis of support has provided rural ILECs with the means to accomplish the goals of Section 254. There is no legitimate reason to change from this proven basis of support to unproven FLEC estimates.

A few wireless carrier interests suggest as a long-term basis of support to use the forward-looking cost of the least-cost or "most efficient" technology to serve a particular high-cost area, as determined by a model.[21] In addition to the problems with FLEC estimates generally, as discussed above, this proposal incorrectly equates lower cost with efficiency and higher cost with inefficiency. Just because providing service using one technology costs more than providing service through another technology does not necessarily make the first technology less efficient. Such a presumption fails to take into consideration the qualitative differences in the services provided through each technology as well as the way in which consumers perceive and use the technologies.

Wireline and wireless technologies, for instance, provide entirely different levels of service quality and reliability, which the FCC has recognized.[22] In addition, most

[19] NASUCA, p. 30.
[20] TDS Telecom, p. 8.
[21] CTIA, p. 27; Western Wireless, pp. 27-28; Dobson, pp. 6-7.
[22] In its Order approving Cingular's acquisition of AT&T Wireless, the FCC recognized that "there remain qualitative differences between wireless and wireline services" and that "wireline local exchange services may have comparative advantages in reliability, E-911 coverage, ubiquity, and lower-cost unlimited local calling." *See, Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation, For*

consumers view their subscription to a mobile wireless service as a complement to their wireline service subscription rather than as a substitute.[23] Furthermore, as NASUCA correctly points out, ILECs continue to serve as the only reliable carrier of last resort, making it unworkable to limit ILEC support to the level of a lower-cost wireless carrier's support.[24]

Another troublesome recommendation is Sprint's proposal to base support for rural, rate-of-return ILECs on the costs of "similarly-situated" rural price cap ILECs.[25] The problem with this proposal is that there is no such thing as a price cap ILEC that is "similarly-situated" to a rate-of-return regulated carrier. Small and mid-size rate-of-return ILECs have always had the option to elect price cap regulation, ever since it was required for the largest ILECs in the early 1990s. Price cap regulation permits carriers to earn returns that are significantly higher than carriers governed by rate-of-return regulation, assuming they are able to continuously lower their costs and/or improve their efficiency. If a rate-of-return ILEC thought that it was able to continually achieve the cost savings and efficiencies that would make price cap regulation beneficial to the

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Consent to Transfer Control of Licenses and Authorizations, WT Docket No. 04-70, *Applications of Subsidiaries of T-Mobile USA, Inc. and Subsidiaries of Cingular Wireless Corporation, For Consent to Assignment and Long-Term De Facto Lease of Licenses,* WT Docket No. 04-254, *Applications of Triton PCS License Company, LLC, AT&T Wireless PCS, LLC, and Lafayette Communications Company, LLC, For Consent to Assignment of Licenses,* WT Docket No. 04-323, Memorandum Opinion and Order, FCC 04-255, ¶247, fn. 559 (rel. Oct. 26, 2004). In addition, in its Triennial Review Order, the FCC recognized that "...wireless CMRS connections in general do not yet equal traditional landline local loops in their quality, their ability to handle data traffic, and their ubiquity." *See, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* CC Docket No. 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket No. 98-147, Report and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17119-17120, ¶230 (2003).

[23] *See, Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,* WT Docket No. 04-111, Ninth Report, FCC 04-216, ¶212 (rel. Sept. 28, 2004) ("...it appears that only a small percent of wireless customers use their wireless phones as their only phone, and that relatively few wireless customers have 'cut the cord' in the sense of canceling their subscription to wireline telephone service.").

[24] NASUCA, p. 34.

[25] Sprint, pp. 3-4.

company and its customers, obviously they would have elected it.[26] The fact that the company did not means that it is substantively different than a carrier that was able to benefit from price cap regulation, even if the two carriers have a similar number of access lines.

The Commission wisely recognized that the diversity of rural ILECs would make mandatory price cap regulation for these carriers poor public policy. It makes no sense, then, to use the costs of a fundamentally different price cap carrier as a proxy for what a rural, rate-of-return carrier's costs "ought to be." Doing so would only serve to threaten the provision of "reasonably comparable" services and rates in rural, rate-of-return carriers' service areas.

Wireless carriers and their representatives like to suggest that the use of embedded costs as the basis of the support, combined with rate-of-return regulation, encourages rural ILECs to operate inefficiently and inflate their costs.[27] Of course, none of these commenters provide any evidence to back up their claims.[28] NECA, however, provides data demonstrating that rural ILECs are, in fact, very cost conscious. Over the past five years, rural ILECs' costs have not even grown as fast as the rate of inflation.[29]

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[26] As the FCC put it in 1993, small and midsize carriers had found they could not elect price cap regulation, in part, because of "their small size, their business cycles are too long to comply with price cap's annual adjustments and [ ] the financial effect of facility upgrades is too great to be reconciled within the Commission's price cap framework." *Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92-135, Report and Order, 8 FCC Rcd 4545, ¶9 (1993).

[27] CTIA, p. 7; Western Wireless, p. 18; Nextel, pp. 3-4; Sprint, p. 3.

[28] A comparison of recent loop cost growth between rural price cap carriers and rural rate-of-return carriers yields virtually no difference. Based on NECA's most recent USF data submission (Oct. 1, 2004), since 2001, rural price cap carriers' average growth in cost per loop is 2.39 percent while the average growth in cost per loop for rural rate-of-return carriers is 2.56 percent. This is hardly evidence that rural rate-of-return carriers are operating inefficiently or inflating their costs.

[29] NECA, pp. 9-10.

The fact is, rural ILECs have a great deal of incentive to act efficiently, and they do so.[30] High-cost support, while certainly a critical source of cost recovery for many rural ILECs, still only comprises a portion of these carriers' total revenues. The significant competitive threats rural ILECs face from wireless carriers, Voice over Internet Protocol providers, and long distance carrier access bypass, among others, force them to operate and invest in a highly judicious manner. Furthermore, rural ILECs face scrutiny and oversight from auditors, regulators, lenders and shareholders.

Wireless carrier interests also like to assert that rate-of-return regulation provides rural ILECs with "guaranteed profits."[31] This is incorrect and demonstrates a misunderstanding of how rate-of-return regulation operates. Rate-of-return regulation merely allows a carrier to target their rates to earn the authorized rate of return. The authorized rate of return is not a minimum on what the carrier may lawfully earn, much less a revenue guarantee.[32] Rate-of-return carriers may lawfully target their rates in any given period to recover their costs plus the authorized rate of return. But if their forecasts are wrong in a year or competition takes traffic on which they had relied in setting their rates, they can earn less than the authorized rate of return for that year. Under those circumstances, rate-of-return regulation only provides the opportunity to set more accurate target rates for the following tariff period. Rate-of-return regulation does not guarantee earnings or revenues and is not inconsistent with competition or efficient operations.

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[30] *See*, NTCA and OPASTCO Ex Parte, Universal Service and the Myth of the Level Playing Field by Dale Lehman, CC Docket No. 96-45, pp. 20-21 (fil. Aug. 12, 2003). *See also,* TSTCI, pp. 9-11; Western Alliance, p. 15; ITCI, p. 11; TDS Telecom, p. 7.
[31] CTIA, p. 10; Western Wireless, p. 17; Nextel, pp. 3-4.
[32] *MCI Telecommunications Corp. v. Federal Communications Commission*, 59 F.3d 1407, 1419 (D.C.Cir. 1995), *cert. denied*, 517 U.S. 1240, 116 S. Ct. 1890 (1996).

In sum, the use of embedded costs as the basis of support for rural ILECs has been highly effective in encouraging prudent investment in high-cost rural areas. This investment has provided rural consumers with access to telecommunications and information services, including advanced services, that are reasonably comparable to those offered in urban areas at affordable and reasonably comparable rates. It would be foolhardy to believe that support based on FLEC estimates would improve upon the high-quality service that rural ILECs provide their customers today. Far more likely a scenario is that a FLEC-based system of support for rural ILECs would bring about a steady decline in the availability and quality of services, and/or increases in local rates, in some instances to levels that are unaffordable. This would be entirely antithetical to the objectives of universal service and must not be permitted to occur.

IV. THERE IS SUBSTANTIAL SUPPORT IN THE RECORD FOR BASING SUPPORT FOR CETCS IN RURAL SERVICE AREAS ON THEIR OWN EMBEDDED COSTS

Like OPASTCO, numerous commenters advocate basing high-cost support for CETCs in rural service areas on their own embedded costs of providing the supported services.[33] These commenters agree with OPASTCO that providing CETCs with the rural ILEC's identical per-line support amount is inconsistent with the language of Section 254, is not competitively neutral, and is causing the Fund to grow unnecessarily at the expense of ratepayers nationwide.

Section 254(b) of the 1996 Act calls for rural consumers to have access to telecommunications and information services that are reasonably comparable to those offered in urban areas at affordable and reasonably comparable rates. When a carrier is

[33] *For example,* ITTA, pp. 32-33; Western Alliance, pp. 22-24; Coalition, p. 11; TSTCI, p. 13; ROTC, p. 9; ATA, pp. 20-22; TCT, pp. 7-8; FW&A, p. 16; GVNW, p. 16; ICORE, pp. 7-11; ITCI, pp. 19-20; Alexicon, p. 15; TDS Telecom, pp. 11-13; FairPoint, pp. 18-19; Home Telephone, p. 7.

able to receive support that exceeds its own costs, it is clearly receiving more support than it needs to achieve these Congressional objectives. This ability to receive excessive support, in turn, provides arbitrage incentives for competitive carriers to seek ETC designation in areas where they may not have otherwise. Indeed, OPASTCO agrees with CTIA that "...*excessive universal service subsidies...distort markets by sending the* wrong signals for investment and competitive entry."[34] Providing support to each ETC based on its own embedded costs would remedy this problem by providing the proper incentives for seeking ETC designation.

Providing CETCs with the ILEC's identical per-line support amount also makes it virtually impossible to ensure compliance with Section 254(e) of the Act, which requires that support only be used for the purposes for which it is intended. Despite what some competitive carriers may believe, increasing profit margins at the expense of ratepayers nationwide is not an intended purpose of high-cost support.[35] By basing CETCs' support on their own embedded costs, there would be greater assurance that these carriers are using the support "only for the provision, maintenance, and upgrading of facilities and services"[36] and that it does not become an incremental revenue source that "is almost all margin."[37]

A couple of commenters assert that basing support on each carrier's own costs would be discriminatory and that only a system in which every ETC serving an area *receives equal per-line support is competitively neutral.*[38] Similarly, a few commenters contend that paying each ETC on the basis of their own costs would penalize the "more

[34] CTIA, pp. 2-3.
[35] *See,* Western Wireless, p. 10; General Communication, Inc. (GCI), pp. 18, 22.
[36] 47 U.S.C. §254(e).
[37] *See, Western Wireless (WWCA): USF Provides Upside to Our EBITDA*, Salomon Smith Barney, p. 2 (Jan. 9, 2003).
[38] CTIA, pp. 14-17; Nextel, pp. 13-14.

efficient" carrier and eliminate incentives for all carriers to operate efficiently.[39] The fundamental flaw with these arguments is that they assume that rural ILECs and CETCs are providing the same level of service and providing service under the same conditions. They are not.

As ATA explains, a CETC "has far fewer regulatory obligations than the incumbent rural carrier, which must meet service quality standards, stand ready to respond to all requests for service in accordance with carrier of last resort obligations, and is subject to rate regulation and tariffing requirements."[40] These ILEC-only requirements impose costs that CETCs do not have to incur. Thus, because the regulatory obligations imposed on rural incumbents and CETCs are unequal, it is not discriminatory to provide each carrier with a different level of support.

In fact, in a competitive environment in which carriers are so differently situated, it does not adhere to the principle of competitive neutrality to provide all ETCs serving an area with the same per-line support amount. Competitive neutrality does require, however, that the same basic *methodology* is used to determine support for each carrier. OPASTCO also agrees with RICA that "competitive neutrality requires support be determined on the basis of the need to meet the statutory goal of rural rates and services comparable to urban, which is best determined by each carrier's cost."[41]

In addition, the suggestion that a CETC is more efficient than the ILEC with which it competes simply because of its lower costs fails to acknowledge the stark differences between ILECs and CETCs. Rural ILECs are very efficient, when taking into

[39] Western Wireless, p. 10; GCI, p. 21; New York State Department of Public Service, p. 3.
[40] ATA, p. 21. With respect to service quality standards, many state commissions require rural ILECs to meet standards for: sufficient capacity to handle peak network traffic, voice quality specifications, the time lag in which a customer receives dialtone, the completion of called numbers, operator and directory assistance answering time, and provisions for emergency operations.
[41] RICA, p. 3.

consideration the high level of service quality and reliability that they provide, the fact that they provide ubiquitous service throughout their service areas, their lack of scale economies, and the regulatory obligations imposed on them at both the federal and state level. It is worth noting that while competitive carriers will claim that rural ILECs are inefficient, they have previously stated their strong opposition to having to meet the same service obligations and regulatory standards imposed on ILECs as a condition of becoming an ETC.[42] Moreover, the contention that basing support on each carrier's own costs will eliminate efficiency incentives fails to recognize that high-cost support is no carrier's sole source of revenue. All ETCs operating in today's highly competitive telecommunications marketplace have ample incentive to strive to improve their efficiency in order to create value for consumers and increase demand for their service offerings.

Several wireless carrier interests attempt to portray rural ILECs as the primary cause of growth in rural high-cost funding, knowing full well that CETCs are the main source of the High-Cost program's rapid escalation in recent years.[43] They create this illusion in two ways.

First, the wireless carriers observe the program's growth over a time span that predates the full implementation of the FCC's access charge reform efforts. In 2000 and 2002, respectively, the FCC implemented Interstate Access Support and Interstate Common Line Support. These mechanisms removed what the Commission believed to be implicit support built into interstate access charges and shifted recovery of those

[42] *For example,* Western Wireless comments in CC Docket No. 96-45, Attachment E, p. 4 (fil. May 5, 2003); Rural Cellular Association and the Alliance of Rural CMRS Carriers comments in CC Docket No. 96-45, p. 23 (fil. May 5, 2003).
[43] CTIA, pp. 3-4; Western Wireless, pp. 7-8; Dobson, p. 3.

revenues to explicit mechanisms within the High-Cost program. Combined, these two mechanisms have added more than $1 billion to the annual funding requirement for the High-Cost program,[44] even though they do not provide rural, rate-of-return ILECs with any additional revenues than they received prior to their implementation. Thus, by including the years in which these mechanisms were introduced, it makes it appear as if the rural ILECs are the primary cause of growth in the program, when in actuality it was changes to the FCC's rules governing ILECs that drove the growth in the program.

Second, the wireless carriers understate the impact that CETCs are having on the program by only including existing CETCs that are actually receiving support and excluding carriers that have ETC applications pending, but for whom support dollars have already been earmarked. The problem with this approach is that USAC includes support amounts for yet-to-be-approved CETCs in its fund demand projections, which determines the current contribution factor. Therefore, the inclusion of support amounts for pending CETCs is appropriate in this type of analysis, since it impacts the contributions that carriers are required to make *today*.

The following chart corrects the flaws in the wireless carriers' analyses. It observes the growth in USAC's quarterly projections for the rural portion of the High-Cost program over the past two years, from 1st Quarter 2003 to 1st Quarter 2005. The figures presented for CETCs include dollars earmarked for both existing and pending CETCs in rural service areas.

[44] *Universal Service Monitoring Report*, CC Docket No. 98-202, Federal and State Staff for the Federal-State Joint Board on Universal Service in CC Docket No. 96-45, p. 3-14, Table 3.1 (rel. Oct. 2004).

($Millions)	1st Quarter 2003 Support	1st Quarter 2004 Support	1st Quarter 2005 Support	% Change 1Q 2003 – 1Q 2005	Two-Year Support Increase	% of Total Two-Year Support Increase
Rural High-Cost Support						
ILEC	$603.1	$609.9	$621.6	3.1%	$18.6	16.6%
CETC	$16.6	$75.7	$109.8	560.5%	$93.1	83.4%
Total	**$619.7**	**$685.6**	**$731.4**	**18.0%**	**$111.6**	**100.0%**

Among other things, this chart illustrates that CETCs are responsible for approximately 83 percent of the growth in the rural portion of the High-Cost program, from 1st Quarter 2003 to 1st Quarter 2005. Over the past two years, the total increase in funding requirement for CETCs in rural service areas, in terms of actual dollars, is approximately five times greater than the total increase in funding requirement for the rural ILECs ($93.1 million vs. $18.6 million).[45] Furthermore, over the past two years, the support earmarked for CETCs in rural service areas grew by a multiple of more than six, while support for rural ILECs increased just three percent. In short, there can be no doubt that it is the CETCs that are driving the rapid growth of the rural High-Cost program. Basing support for all ETCs in rural service areas on their own embedded costs would effectively address this problem, while still ensuring that all ETCs receive sufficient support to encourage investment and provide universal service.

Finally, numerous parties are supportive of the interim "safe harbor" plan filed by the Rural Telecommunications Associations in the FCC's proceeding on the Joint

[45] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2003,* Appendix HC01 (Nov. 1, 2002); Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2005,* Appendix HC01 (Nov. 2, 2004).

Board's Portability Recommended Decision.[46] As OPASTCO explained in its initial comments, the interim plan would provide wireless CETCs with a "safe harbor" percentage of the rural ILEC's per-line support, with the specific percentage determined by the size of the wireless carrier.[47] Adoption of this plan as an interim mechanism would enable the Commission to immediately get the excessive growth in the High-Cost program under control while it develops equivalent cost reporting rules for CETCs.

It is critical that the public have the utmost confidence that the High-Cost program they pay for is being used judiciously, for the purposes for which it is intended, and is achieving its objectives. This can only occur if support for all ETCs in rural service areas is based on each carrier's embedded costs of providing the supported services. NASUCA sums up the issue best when it states that "[t]he *high cost* support fund should support carriers with *high costs*. Incumbent rural carriers have to show their costs; so should CETCs."[48]

[46] TSTCI, pp. 15-16; FW&A, p. 16; ATA, p. 22; GVNW, pp. 16-17. *See also,* Reply Comments filed in CC Docket No. 96-45 on Sept. 21, 2004 by: The Rural Carriers, pp. 2-5; NECA, p. 9; Mid-Size Carriers, pp. 25-26; Montana Independent Telecommunications Systems, pp. 9-11; TSTCI, pp. 7-8; FW&A, p. 17. *See also,* Montana Public Utility Commission Reply Comments in CC Docket No. 96-45, p. 6 (fil. Sept. 22, 2004).

[47] OPASTCO, pp. 17-18. *See also,* Rural Telecommunications Associations comments in CC Docket No. 96-45 (fil. Aug. 6, 2004); Rural Telecommunications Associations Reply Comments in CC Docket No. 96-45 (fil. Sept. 20, 2004).

[48] NASUCA, p. 36.