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

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

TO: The Federal-State Joint Board on Universal Service

COMMENTS OF THE WESTERN TELECOMMUNICATIONS ALLIANCE AND INDEPENDENT TELEPHONE AND TELECOMMUNICATIONS ALLIANCE

Gerard J. Duffy
Blooston, Mordkofsky, Dickens,
Duffy & Prendergast
2120 L Street, NW (Suite 300)
Washington, DC 20037
Telephone: (202) 659-0830
E-mail: gjd@bloostonlaw.com

David W. Zesiger
Independent Telephone and
Telecommunications Alliance
888 16th Street, NW (Suite 800)
Washington, DC 20006
Telephone: (202) 355-1388
Email: dzesiger@itta.us

Dated: September 30, 2005

TABLE OF CONTENTS

SUMMARY

The Western Telecommunications Alliance ("WTA") and the Independent Telephone and Telecommunications Alliance ("ITTA") comment upon four proposals by state members and staff of the Joint Board regarding the determination and distribution of Federal high-cost support.

WTA and ITTA recognize that changing industry and technology conditions may require adjustments to Federal universal service mechanisms. However, the criterion for evaluation of any and all such adjustments is the extent to which they advance the predominant goal of the 1996 Act and the Federal universal service program – namely, the promotion of investment in critical telecommunications infrastructure. While WTA and ITTA support state proposals for use of embedded costs and for a separate "wireless portability fund," they vigorously oppose the allocation of Federal support via block grants to the states and the delegation to state commissions of authority to distribute Federal support to eligible telecommunications carriers ("ETCs") within each state. WTA and ITTA also oppose state proposals for consolidation of all commonly-owned study areas within a state, and for the shift of certain rural telephone companies to the High Cost Model used to distribute Federal support to the Regional Bell Operating Companies ("RBOCs") and other "non-rural" carriers.

The proposed delegation to state commissions of decision-making authority over Federal high-cost support is precluded by well-settled administrative law and constitutional law principles. Section 254 of the Communications Act clearly gave the Commission sole decision-making authority over Federal universal service rules and

mechanisms. In *United States Telephone Association v. FCC*, 359 F3d 554, 565-68 (D.C. Cir. 2004), the Court of Appeals for the D.C. Circuit recently reiterated the controlling principle that federal agencies may not sub-delegate their decisional authority to outside entities (private or sovereign) without affirmative statutory authority. Moreover, in *New York v. United States*, 505 U.S. 144 (1992), and *Printz v. United States*, 521 U.S. 898 (1997), the Supreme Court has ruled that Tenth Amendment dual sovereignty principles preclude the Federal Government from compelling the States or State officials to administer Federal regulatory programs like the Federal universal service program.

Even if it could pass judicial muster, the proposed replacement of the existing Federal mechanism by multiple state mechanisms will create more problems than it will resolve. First and foremost, the uncertainties, costs and targeting defects of block grants and multiple state distribution mechanisms will destroy the certainty of cost recovery needed by small rural carriers, investors and lenders to make substantial and long-term investments. Block grants based upon statewide average costs also will reduce the targeting of Federal support to the high-cost areas and small rural carriers that need it the most. And more Federal support is likely to be distributed to larger carriers that do not need it and that are less likely to use it to upgrade their rural exchanges.

Multiple state mechanisms will massively increase the complexity and cost of administering the Federal universal service program. The states will incur legislative, rulemaking, litigation, personnel and training costs, and will not enjoy the economies of scale of a national mechanism. The Universal Service Administrative Company

("USAC") will encounter increased costs, complexities and timing bottlenecks in dealing with multiple state mechanisms. The Commission itself may have new administrative tasks (e.g., allocation of block grants and state compliance oversight) comparable to or greater than its current responsibilities for the existing nationwide mechanism.

Multiple state mechanisms are likely to cause universal service support to become insufficient for many small rural carriers. There are several far more efficient and effective alternatives for controlling the size and growth of the Federal high cost program, including limiting designations of multiple ETCs in rural service areas, stopping the transfer of further access charge and other intercarrier compensation revenue streams into universal service mechanisms, and calculating support for all ETCs on the basis of their own actual reasonable and prudent costs.

The proposed consolidation of rural telephone company study areas and the proposed transfer of some "100,000-line" rural telephone companies to the High Cost Model developed for the RBOCs and other "non-rural" carriers should also be rejected. Both proposals would discourage and reduce investment in critical rural telecommunications infrastructure. In addition, the High Cost Model proposal disregards the multiple statutory criteria for qualification as a "rural telephone company," and unreasonably treats some rural telephone companies different than others.

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

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

TO: The Federal-State Joint Board on Universal Service

COMMENTS OF THE WESTERN TELECOMMUNICATIONS ALLIANCE AND INDEPENDENT TELEPHONE AND TELECOMMUNICATIONS ALLIANCE

The Western Telecommunications Alliance ("WTA") and the Independent Telephone and Telecommunications Alliance ("ITTA") submit their comments on the four proposals advanced by state members and staff of the Federal-State Joint Board on Universal Service ("Joint Board") regarding the future distribution of Federal high-cost support.[1] These comments are filed in accordance with the procedures set forth in the Commission's Public Notice (Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules Relating to High-Cost Universal Service Support), FCC 05J-1, released August 17, 2005.

WTA and ITTA recognize that changes will be necessary to sustain Federal high-cost universal service mechanisms so that they can continue to encourage and enable investment in critical rural telecommunications infrastructure. They applaud the efforts of the state members and staff of the Joint Board to consider the problems and

[1] The four plans are: (1) the "State Allocation Mechanism" ("SAM") proposed by Joint Board Member Ray Baum; (2) the "Three Stage Package for Universal Service Reform" ("TSP") proposed by Joint Board Member Billy Jack Gregg; (3) the "Holistically Integrated Package" ("HIP") proposed by Commissioner Robert Nelson; and (4) the "Universal Service Endpoint Reform Plan" ("USERP") proposed by Joel Shifman, Peter Bluhm and Jeff Pursley.

complexities of universal service support, and to begin to formulate potential modifications and alternatives. WTA and ITTA agree with the SAM and USERP proposals that embedded costs are a more accurate and reliable basis than forward-looking economic costs ("FLEC"), for calculating and distributing universal service funds.[2] They also believe that the separate "wireless portability fund" proposed by USERP deserves serious consideration.[3]

However, WTA and ITTA strongly disagree with the proposals for allocation of Federal universal service support via block grants to the states, and the delegation to state commissions of the authority to determine the amounts (if any) of such Federal support to be distributed to the various eligible telecommunications carriers ("ETCs") within their states.[4] Such a sub-delegation to state agencies of the Commission's decision-making power regarding Federal universal service funding is not authorized by the Communications Act, contravenes established constitutional and administrative law principles, and would create many more problems and inequities than it would resolve.

WTA and ITTA also vigorously oppose the state proposals for consolidation of all study areas owned by a single company within a state,[5] and for shifting of rural carriers serving 100,000 or more lines in a state to the High Cost Model used to calculate and distribute high-cost support to non-rural carriers.[6] Both proposals would also discourage and reduce investment in telecommunications infrastructure that is critically needed in high-cost rural areas.

---

[2] See SAM proposal, at p. 4; and USERP proposal, at pp. 20-21.
[3] See USERP proposal, at pp. 26-27.
[4] See SAM proposal, at pp. 3-4; TSP proposal, at p. 12; HIP proposal, at pp. 14-16; USERP proposal, at pp. 21-25.
[5] See TSP proposal, at p. 8; HIP proposal, at p. 17.
[6] See TSP proposal, at p. 8.

I

The Western Telecommunications Alliance

The Western Telecommunications Alliance is a trade association that was formed by the merger of the Western Rural Telephone Association and the Rocky Mountain Telecommunications Association. It represents approximately 250 rural telephone companies operating west of the Mississippi River.

WTA members are generally small independent local exchange carriers ("ILECs") serving sparsely populated rural areas. Most members serve less than 3,000 access lines overall, and less than 500 access lines per exchange. Most members also generate revenues much smaller than the national telephone industry average, and rely upon Federal high cost dollars for the recovery of approximately 25-to-50 percent of their costs.

WTA members serve remote and rugged areas where loop, transport and switching costs per customer are much higher than in urban and suburban America. Their primary service areas are comprised of sparsely populated farming and ranching regions, isolated mountain and desert communities, and Native American reservations. In many of these areas, the WTA member not only is the carrier of last resort, but also is the sole telecommunications provider ever to show a sustained commitment to invest in and serve the area.

WTA members are highly diverse. They did not develop along a common Bell System model, but rather employ a variety of network designs, equipment types and organizational structures. They must construct, operate and maintain their networks under conditions of climate and terrain ranging from the deserts of Arizona to the rain forests of Hawaii to the frozen tundra of Alaska, and from the valleys of Oregon to the plains of Kansas to the mountains of Wyoming.

Predictable and sufficient cost recovery is essential to WTA members if they are to continue investing in and operating telecommunications facilities in high-cost rural areas, while providing quality services to their rural customers at affordable rates. Therefore, WTA has found it necessary to participate in this and other proceedings that affect the Federal High Cost Fund.

II

The Independent Telephone and Telecommunications Alliance

The Independent Telephone and Telecommunications Alliance (ITTA) was formed in 1994 and represents ten midsize incumbent local exchange carriers which collectively provide local exchange and exchange access service to over seven million lines in 43 states. ITTA's member companies are integrated communications providers offering a broad range of services to their customers including local, interexchange, internet, broadband, video, and wireless services. ITTA member companies serve a wide variety of communities across the country, many of which are rural and high cost. They serve some of the most difficult and expensive areas to serve in the nation, including a Native American community at the bottom of the Grand Canyon, portions of Alaska and isolated islands off the coast of Maine.

III

Administrative and Constitutional Law Preclude Sub-Delegation To States of Authority over Federal Universal Service Mechanisms

Established principles of administrative law and the constitutional dual sovereignty prohibit the Commission from sub-delegating to state commissions the Commission's decision-making authority over Federal universal service mechanisms, including determinations regarding the distribution of Federal universal service support dollars among ETCs within states.

WTA and ITTA support the establishment and administration of supplemental state universal service funds by state commissions. The universal service principles in Section 254(b) of the Act include the principle that "[t]here should be specific, predictable and sufficient *Federal and State* mechanisms to preserve and advance universal service [emphasis added]." 47 U.S.C. Sec. 254(b)(5). The states were given explicit authority in Section 254(f) of the Act to design and implement their own separate universal service programs and mechanisms, so long as such state plans "do not rely on or burden Federal universal service support mechanisms." Whereas some states (e.g., Arkansas, California, Nevada, Oregon and Wyoming) have established their own supplemental universal service funds, several of the existing state mechanisms have been the subject of political attacks and legislative proposals that have raised questions regarding their future existence or sufficiency. WTA and ITTA hope that this opposition and uncertainty can be soon put to rest, and that all states containing high-cost rural and insular areas act to establish or strengthen their own specific, predictable and sufficient State universal service programs.

However, Section 254 of the Communications Act limits state commission authority over universal service mechanisms to State mechanisms, and gives the Commission sole decision-making authority over Federal universal service rules and mechanisms. Section 254(a)(1) provides for limited state input by assigning to the federal and state members of the Joint Board the task of recommending to the Commission, from time to time, changes to Federal universal service regulations and programs. But Section 254(a)(2) then expressly reserves to the Commission the ultimate and exclusive authority to establish and implement Federal universal service rules and mechanisms. Section 254(d) reiterates the Commission's sole responsibility for establishing specific, predictable, and sufficient federal mechanisms to preserve and advance universal service.

WTA and ITTA recognize that Section 214(e) gives state commissions the authority in many instances to designate common carriers as ETCs eligible to receive Federal and State universal service support. However, the Section 214(e) delegations are limited solely to ETC designations, and do not include any explicit or implicit authority over the establishment, implementation or administration of the Federal universal service mechanisms themselves.

During the almost ten years since the enactment of the Telecommunications Act of 1996, there has been no serious question or dispute that Congress gave the Commission sole authority over the establishment and operation of Federal universal service mechanisms. All decision-making authority over the Federal universal service program and mechanisms has been exercised by the Commission, while only "exclusively administrative" functions (such as billing contributors, collecting contributions, and disbursing funds) have been delegated to and performed by the Universal Service Administrative Company ("USAC") pursuant to the Commission's regulations and instructions.[7]

In *United States Telephone Association v. FCC*, 359 F3d 554, 565-68 (D.C. Cir. 2004) ("*USTA* decision") the U.S. Court of Appeals for the D.C. Circuit held that the Commission and other federal agencies may not sub-delegate their decision-making authority to outside entities – private or sovereign – absent affirmative evidence of statutory authority to do so. The court therein voided sub-delegations by the Commission to state commissions of certain determinations under Section 251(d)(2) regarding unbundled network elements ("UNEs"). It found that delegations of authority to the states in Section 252 to arbitrate and approve agreements (that may include UNE arrangements) did not infer or authorize a state role under Section 251(d)(2) to determine what UNEs must be made available. The Commission's sub-delegation of its Section 251(d)(2) UNE authority to the states was vacated on the principle that "the general conferral of regulatory authority does not empower an agency to sub-delegate to outside parties." *Id.* at 568.

The *USTA* decision explained that sub-delegations of authority to state commissions and other outside parties may blur lines of responsibility and accountability, thereby undermining an important check on government decision-making. *Id.* at 565. In addition, the court noted that such sub-delegations increase the risk that at least certain

---

[7] See *Third Report and Order in CC Docket No. 97-21, Fourth Order on Reconsideration in CC Docket No. 97-21, and Eighth Order on Reconsideration in CC Docket No. 96-45*, 13 FCC Rcd 25058 (1998), at par. 16; 47 C.F.R. Sec. 54.702(b).

state commissions and other outside parties will not share the Commission's national vision and perspective. *Id.* at 565-66.

The *USTA* decision applies fully and equally to Section 254, and precludes the Commission from sub-delegating determinations regarding the distribution of Federal universal service support. Sections 254(a) and 254(d) give the Commission sole jurisdiction over Federal universal service mechanisms. Whereas Sections 214(e) and 254(f) provide for a state role in ETC designations and supplemental state universal service programs, they give state commissions absolutely no decision-making authority over the Federal universal service mechanisms. In other words, nothing in Section 254 gives the Commission any explicit or implicit authority to sub-delegate to state commissions any decision-making authority over Federal universal service mechanisms. Therefore, because they would be voided by the courts under existing administrative law principles, the proposed block grant and state allocation/distribution mechanism alternatives should be rejected.

Moreover, the administrative law barriers cannot be avoided or eliminated by Congressional amendment of Section 254. The U.S. Supreme Court has held that the constitutional system of dual sovereignty embodied in the Tenth Amendment precludes the Federal Government from compelling the States to enact or administer federal regulatory programs. *New York v. United States*, 505 U.S. 144 (1992). This prohibition encompasses Congress as well as subordinate federal agencies such as the Commission. And the prohibition is effective even if state officials consent to or support a particular federal program. Justice O'Connor, writing for the Court, specifically held that state officials cannot ratify or consent to actions or directives of the Federal Government that exceed the federal powers enumerated in the Constitution. *Id.* at 182.

Subsequently, in *Printz v. United States*, 521 U.S. 898 (1997), the Supreme Court extended this Tenth Amendment prohibition to State officers or officers of State political subdivisions as well as to the States themselves, and to ministerial actions as well as to policy making. Justice Scalia, writing for the Court, held that Congress cannot circumvent the *New York v. United States* prohibition against compelling the States to enact, administer or enforce a federal regulatory program by conscripting the State's officers directly. He stated that it "matters not whether policymaking is involved, and no case-by-case weighing of the burdens or benefits is necessary; such commands are fundamentally incompatible with our constitutional system of dual sovereignty." *Id.* at 935.

Whatever their operational merits or defects, the proposed block grant and state allocation/distribution mechanisms do not constitute a viable or feasible alternative. Not only do well-settled administrative law principles prohibit the sub-delegation of Federal agency jurisdiction to states and other outside parties, but also the dual sovereignty principles of the Tenth Amendment prohibit the Federal government from requiring the states and state officials to administer Federal regulatory programs. The Joint Board and Commission need to focus instead upon alternatives that retain the mandated exclusive Commission authority over Federal universal service mechanisms.

IV

Block Grants and State Allocation/Distribution Mechanisms Entail Significant Implementation and Operational Problems

The primary goals of Federal universal service reform should be: (1) to continue the success of the High Cost Fund program in encouraging and enabling investment in essential rural telecommunications infrastructure; while (2) minimizing the costs and complexities of administering the Federal universal service mechanisms; and (3) controlling the growth of the Federal universal service mechanisms without rendering them insufficient. The proposed block grants and state allocation/distribution mechanisms will have substantial adverse impacts upon investment incentives, fund administration, and the sufficiency of Federal support. Moreover, there are more effective ways to control the size and growth of the universal service program.

A. Block Grants and State Allocations/Distributions Will Discourage Investment

The predominant objective of the entire Telecommunications Act of 1996, as well as its Section 254 universal service provision, is the encouragement of private sector investment in telecommunications networks. The Conference Report for the 1996 Act explicitly declared that the Act was "designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans." 142 Cong. Rec. H1078 (January 31, 1996). Throughout the more populous areas of the country, the 1996 Act encouraged investment by reducing regulation and by promoting competition among entities in the converging local telephone, long distance telephone, cable television and computer industries. However, recognizing that competition might not develop in certain rural areas, Congress added the universal service provisions of Section 254 as a "safety net" to encourage the desired telecommunications investment in areas where incentives were weak due to high costs, low revenue potential, limited customers, and uncertain cost recovery.

The pre-1996 Universal Service Fund and the Section 254 Federal high cost mechanisms have been successful, to date, in providing sufficient cost recovery to enable WTA and ITTA members and other rural telephone companies to invest in the telecommunications infrastructure necessary to offer their rural customers high quality and affordable services reasonably comparable to those available in urban areas. These network investments have permitted many rural communities and their residents to participate in the economic, political, social and public safety affairs of the nation. In addition, they have created the jobs and economic opportunities needed by rural communities to retain their young families, their children, their schools and their lifestyles, as well as to attract new residents and businesses.

Block grants and multiple new state allocation/distribution mechanisms will threaten, and very likely impair or destroy, the pro-investment successes of the Federal universal service programs. First, the very shift from a uniform, national distribution mechanism to fifty or so separate state distribution mechanisms will, by itself, greatly increase uncertainty and decrease investment incentives. Some state commissions have a record of encouraging and enabling rural carriers to make reasonable and prudent investments in their rural service areas; other state commissions have had little or no previous responsibility or experience in regulating at least some classes of rural carriers; and yet other state commissions have been perceived as more interested in larger wireline and wireless carriers or less interested in small rural carriers. Particularly in the latter two instances, many small rural carriers that rely upon Federal support to recover substantial portions of their investment costs will no longer be certain of its availability and sufficiency during the projected useful lives of their contemplated new facilities and upgrades, and will therefore have greatly reduced incentives to make such investments. Moreover, this increased uncertainty will reduce or destroy the financial capability of many small carriers to make infrastructure investments by driving away potential investors and lenders and/or by driving up their costs of investment capital.[8] In other words, the proposed transfer of responsibility for distribution of Federal universal service support from the existing nationwide mechanism to fifty or so different state mechanisms will kill, suspend or delay many potential rural infrastructure investment projects unless and until small rural carriers can reliably predict that they will receive sufficient Federal high cost support from their state commissions.

Second, the establishment of Commission guidelines for state commission allocation and distribution of Federal support will not significantly alleviate the uncertainty problems. The state proposals all appear to assume or require that state commissions will have significant discretion to make their own allocations and distributions of Federal support. In that case, the contemplated Commission guidelines could be only general guidelines like the Commission's non-mandatory ETC guidelines, and state commissions would be free to interpret, follow or disregard them pretty much as they wished. The more discretion that state commissions have to distribute Federal

[8] Some WTA and ITTA members have perceived significant increases in reluctance by the Rural Utilities Service, the Rural Telecommunications Finance Cooperative, CoBank, and local banks to make loans to them for infrastructure additions and upgrades during recent years, as well as substantially more onerous terms, conditions and interest rates for potential loans that have been discussed. They believe that these changes have resulted from the uncertainty regarding their ability to repay such loans that has arisen, in significant part, due to various pending proposals for "bill and keep" and universal service "reform."

support, particularly as statewide average costs and block grants change, the more uncertainty small carriers and their investors/lenders will have that they can recover their investment costs. Put another way, if the Commission were to adopt very specific guidelines that would increase certainty and strictly limit the distribution options of state commissions, why not just retain the established and uniform Federal mechanisms administered by the Commission?

Third, the proposed use of five-year block grants and/or five-year state allocation and distribution plans will not reduce uncertainty enough to encourage investment.[9] Fiber and other loop investments have useful lives and cost recovery periods considerably longer than five years -- generally, fifteen to forty years. Whereas a five-year plan may represent a substantial commitment by a regulatory agency, it unfortunately falls far short of the lengthy period necessary to recover the costs of rural transmission facility investments.

Fourth, block grants based upon statewide average costs will disrupt and reduce the targeting of Federal universal service support to the carriers that most need it -- the small rural carriers with minimal access to capital markets that serve rugged and isolated high-cost areas that larger carriers have long ignored or avoided. Federal support may be eliminated or reduced for many small rural carriers serving high-cost areas of lower cost states. For example, assume that Carrier X is an ETC that serves 1,100 access lines in a single mountainous study area in State A where its costs are 200 percent of the national average. Under the existing system, Carrier X receives a substantial amount of Federal high cost support to help recover the costs of its existing infrastructure investments and to

---

[9] SAM proposal, p. 5.

enable it to make future upgrades and investments. However, if State A has substantial urban centers as well as isolated mountain regions, its statewide average costs may be less than the national average. In that case, at least some of the state proposals would appear to give State A no block grants from which to distribute Federal high-cost support to Carrier X. Likewise, if State A has statewide average costs only a few percentage points above the threshold for receiving a block grant, its ultimate block grant may not be large enough to distribute Federal support comparable to that currently received by Carrier X. In contrast, if State B has statewide average costs far above the national average, it might receive block grants greater than the amount necessary to provide the current levels of support to the ETCs serving its high-cost areas. While the current Federal mechanisms certainly are not perfect, they are much better able to target support to the actual high-cost areas where it is needed than are block grants based upon statewide average costs.

Fifth, it is not clear whether or how the Part II support proposed by the USERP plan, or the supplemental state universal service support alluded to by the TSP plan[10] would efficiently and economically resolve the foregoing block grant and statewide averaging problems. The existing uniform Federal mechanisms effectively target all high cost service areas whether they are located in states with high, moderate or low statewide average costs. Whereas states are free to establish their own supplemental universal service mechanisms, it does not appear that the proposed Part II mechanism would encourage investment and recover costs in high-cost areas within lower-cost states more efficiently and less expensively than the present Federal mechanisms.

---

[10] USERP plan, at p. 23; TSP plan, at p. 11.

Finally, the state proposals appear designed, at least in part, to distribute substantially more Federal universal support to the Regional Bell Operating Companies ("RBOCs") and other large carriers. Whereas some rural exchanges served by large carriers may have below-average telecommunications service and/or infrastructure, this is not because the large carriers lack the funds for upgrades of their rural exchanges. Rather, the most attractive and productive investments for RBOCs and other large carriers that serve both rural and non-rural areas in a state generally do not include substantial upgrades of their rural exchanges.

In the past, state service quality requirements have prodded some large carriers to upgrade their rural exchanges, or to sell them to smaller carriers who would. If the state members desire to improve service in rural exchanges served by larger carriers, the most effective tactic would be to revisit or increase state minimum service quality requirements for all wireline and wireless carriers, and to apply them to areas smaller than the entire state.

In contrast, providing millions of dollars of additional Federal universal service support to large, multi-billion dollar carriers is not likely to change their investment priorities or behavior. Whereas the existing High Cost Model applicable to the RBOCs and other large "non-rural" carriers is designed to distribute support to high-cost exchanges in certain above-average-cost states, it appears to have had little impact outside of some rural portions of Texas and Mississippi served by the RBOCs. Where Federal support is provided to the RBOCs and other large carriers, price cap regulation has stripped many state commissions of significant authority over their rates and costs, and will hinder or preclude state commissions from determining whether price cap carriers have invested Federal universal service support in their "rural" exchanges.

In sum, the proposed block grants and state-by-state allocations/distributions will discourage critically needed investments in rural telecommunications infrastructure. They will render cost recovery very uncertain for the small rural carriers that must rely upon Federal universal service support to recover major portions of their infrastructure investment. By using statewide average costs, they will create arbitrary winners and losers, and disrupt the targeting of Federal support to the high-cost areas and small rural carriers that need it the most. Finally, they will distribute substantially more Federal high cost support to larger carriers that do not need it and that are less likely to use it to upgrade their rural exchanges.

B. Multiple State Mechanisms Will Significantly Increase the Complexity and Expense of Universal Service Administration

Fifty or so new and separate state allocation and distribution mechanisms will substantially increase the complexity and cost of administering the Federal universal service program.

In many states, legislation will have to be drafted, debated, enacted and signed to authorize the state commission to seek, accept, allocate and distribute the Federal block grants. At minimum, state commissions will have to conduct rulemakings to adopt the regulations and procedures needed to: (a) implement new state legislation; (b) specify, collect and verify the cost data necessary to calculate statewide average costs; (c) submit and substantiate statewide average cost data to the Commission or other entity authorized to allocate Federal block grants; (d) participate in the Federal proceedings that allocate block grants to the various states, plus associated reconsiderations or appeals; (e) specify, collect and verify the data needed to determine how much of each Federal block grant to distribute to each ETC in the state; (f) conduct the proceedings and issue the orders distributing each Federal block grant to the various ETCs, plus any resulting reconsideration or appeal proceedings; (g) specify, collect and verify the data necessary to calculate and distribute any supplemental Part II or state support; and (h) conduct the proceedings and issue the orders or documents necessary to obtain or collect supplemental Part II or state support and distribute it to the various ETCs, plus any resulting reconsideration or appeal proceedings. After completing the initial rulemakings (and possibly some later rulemakings to modify the initial regulations and procedures), the various state commissions will have to conduct the various block grant, allocation and distribution proceedings on an annual or other recurring basis. Although the contemplated proceedings are not described in detail in the state proposals, it appears that the block grant distribution and supplemental Part II support determination proceedings may be very similar to full-fledged rate cases, albeit with multiple wireline and/or wireless carriers needing to justify their revenue requirements and desired Federal support.

Once the state commissions complete the proceedings necessary to determine how much support is to be distributed for the period to each ETC, they will have to instruct the Universal Service Administrative Company ("USAC") how to make the distributions. USAC will need to increase its staff and expenses significantly in order to keep abreast of, understand and implement the distribution regulations and determinations of as many as fifty separate states. USAC will also suffer substantial planning and timing bottlenecks as it is forced to wait for various state commission rulings before it can plan and make distributions, and will then forced to work its staff overtime to catch up when multiple state rulings arrive late in the distribution period.

The loss of economies of scale predicts that fifty or so state distribution mechanisms and proceedings will be much more expensive to administer than the existing Commission/USAC system. The training, new employees and man-hours needed to conduct multiple state commission rulemakings to adopt the various state allocation/distribution mechanisms will impose substantial and unnecessary new costs upon state taxpayers (or upon universal service contributors if such costs are recovered from the USF itself). And these initial rulemaking costs will be only a small fraction of the recurring costs necessary to conduct periodic state commission distribution proceedings, particularly if they take the form of rate cases.

The Commission is reviewing USAC's procedures and performance in another portion of this Docket. WTA and ITTA believe that, whatever problems and inefficiencies (if any) are found with respect to the existing nationwide mechanism, they will be small compared to those that will be encountered if the existing system is scrapped in favor of fifty or so separate state mechanisms.

C. Block Grants and State Allocation/Distribution Mechanisms Are Not the Best Way to Reduce the Size or Growth of the Federal Universal Service Program

At present, the most effective way to control the growth of the Federal high cost mechanisms is for state commissions to limit their designations and certifications of ETCs, particularly multiple ETCs serving the same rural service areas. Some state commissions have done this. However, others appear to have decided to maximize the amount of "free" Federal universal service dollars coming into their states by designating and certifying as ETCs virtually any carriers that request such designation. Consequently, the Federal mechanisms are currently providing support to multiple wireline and wireless carriers in some rural service areas. These numbers may increase within the foreseeable future, as cable operators seek ETC status for their telecommunications operations.

Another effective approach is to continue to require interexchange carriers, and to require wireless carriers and interconnected Voice over Internet Protocol ("VoIP") carriers, to pay reasonable intercarrier compensation for their use of the lengthy and expensive "last mile" facilities of rural telephone companies to originate and/or terminate their traffic. Since the passage of the 1996 Act, the Commission has transferred approximately $500.86 million in annual Long Term Support ("LTS"), $426.72 million in annual Local Switching Support ("LSS"), approximately $650.00 million in annual Access Universal Service Fund support ("AUSF") and over $372.34 million in annual Interstate Common Line Support ("ICLS") from interstate access charges into the Federal High Cost Fund. Pending proposals in CC Docket No. 01-92 for replacement of substantial existing intercarrier compensation by a mandatory "bill and keep" system could add another $1.0 or $2.0 billion of cost recovery to the Federal High Cost Fund. Efficient investment and business planning requires carriers to pay for their use of expensive "last mile" facilities, rather than transferring the cost of their usage into the Federal high cost mechanisms to be paid by others.

Yet another effective way to control the size and growth of the Federal mechanisms is to allow ETCs to recover only their actual costs, and to limit such cost recovery to reasonable and prudent costs. As the USERP plan accurately recognizes, wireline and wireless networks, in particular, have very different cost characteristics.[11] It has never made any sense to calculate Federal high cost support for wireless and other competitive ETCs on the basis of the different costs of incumbent rural telephone companies. The actual historical/embedded costs of each ETC constitute the most accurate and equitable basis for calculating its Federal universal service support.

The major argument against embedded costs is that they encourage inefficiency and over-investment. This canard has never been proven against the vast majority of rural telephone companies.[12] However, even if inefficiency and over-investment were actual and significant problems, they could be readily and effectively addressed and controlled by audits that would disallow investments and investment costs that were not reasonably and prudently made. Such audits would entail additional expense, but would be far less costly and more efficient than the many new rulemakings and state distribution proceedings necessary to implement the state proposals. WTA and ITTA submit that the most effective and efficient approach would be to retain the present uniform Federal mechanisms, and use the money saved by the states and USAC to conduct additional and improved audits to ensure that supported investments and costs are reasonable and prudent.

The proposed "hold harmless" transition mechanisms of the state proposals may create disruptions and unintended consequences. If a hold harmless adjustment like the

---

[11] USERP plan, p. 26.

[12] Most of the 1,100 rural telephone companies are small businesses or cooperatives that do not have ready access to capital markets or major commercial banks. Rather, they must invest efficiently and conservatively in order to obtain financing from the very small circle of lenders that have shown willingness to finance them – namely, the Rural Utilities Service, the Rural Telecommunications Finance Corporation, CoBank, and a few local banks. In addition, many rural telephone companies have their

"dollar-per-month-per-line" reduction proposed by the USERP plan[13] is employed, the transition period will last for decades in some high-cost areas. On the other hand, if the transition period from the existing Federal mechanisms to the state allocation mechanisms is short, there will be substantial decreases in support received by some rural a carriers that will, in turn, produce rate shock, halt investment plans and projects, and force consideration of bankruptcy and other reorganization options.

Finally, WTA and ITTA emphasize that specificity, predictability and sufficiency constitute the express and controlling goals of the Federal universal service mechanisms. Whereas the size and growth of the Federal mechanisms need to be controlled so that they remain sustainable, they need to remain specific, predictable and sufficient above all. State proposals to freeze high cost support upon competitive entry[14] or at Second Quarter 2006 levels[15] have no relation to the reasonable and prudent costs that need to be recovered, but rather will reduce the size of the Federal program to insufficient levels. Likewise, restricting Federal high cost support to a fixed percentage of "excess" (above-average) costs will result in insufficient support where states decline to establish their own supplemental state universal service funds. Rural telephone companies and their lenders can not and will not invest in critical telecommunications infrastructure unless they have reasonable expectations of recovering 100 percent of their investment costs.

---

investment plans and financing scrutinized by their boards of directors, and their investment costs audited by the National Exchange Carrier Association ("NECA") and/or their state commissions.

[13] USERP plan, p. 23.

[14] TSP plan, p. 8.

[15] SAM plan, p. 6.

V

Study Area Consolidations and 100,000 Line Reclassifications Will Discourage Critical Rural Infrastructure Investment

The state plans include proposals for consolidation of rural telephone company study areas and for the transfer of certain "larger" rural telephone companies (i.e., those serving 100,000 or more lines within a state) to the High Cost Model used to calculate and distribute high-cost support for the RBOCs and other large "non-rural" carriers. These proposals are transparently intended to reduce the amount of high-cost support distributed to rural telephone companies. However, the potential cost savings are limited, and are outweighed by the decreased incentives for critical infrastructure investment in the affected rural areas.

A. Study Area Consolidations Will Impair Rural Investment

Many of the nation's approximately 1,100 rural telephone companies operate a single study area within a single state. However, some small and mid-sized rural telephone companies have more than one study area in certain states. Most of these multiple study areas are the result of post-November 15, 1984 acquisitions by rural telephone companies of other rural telephone companies. In the majority of cases, these multiple study areas have continued to be operated independently as separate telephone companies and networks, with their own separate switches, transmission lines and local managements.

Arbitrarily consolidating these multiple study areas may produce some limited operating expense reductions, albeit at a cost to the affected rural communities. Some local customer service offices may be able to be closed; and some local management, customer service and clerical jobs may be able to be eliminated. However, in most instances, it will not be economically or technically feasible to consolidate or reconfigure the switches, loops or inter-office transmission facilities of the separate study areas within the foreseeable future. In other words, consolidation of rural telephone company study areas is not likely to produce consolidation of separate rural telephone company networks or reduction of rural telephone company network costs. Moreover, where holding companies owning and operating multiple rural telephone company study areas have been able to realize economies of scale – for example, by consolidating certain accounting, billing, legal and other administrative functions – the cost savings have already been passed through to the Federal universal service mechanisms in the form of reduced embedded administrative costs allocated among the affected study areas.

The overriding disadvantage of study area consolidation is that it will reduce the targeting of Federal high-cost support to the high-cost rural areas that need it the most, thereby disrupting the recovery of investment costs and decreasing incentives for future rural infrastructure investment. Arbitrarily combining study areas of varying geographic size, population, population density, terrain, loop lengths, access line numbers, developmental history and network design simply because they are currently owned by the same entity or affiliated group will produce consolidated "loop" and "switching" costs that have no specific relationship to any of the separate, affected study area networks. The breaking of the existing links between Federal support and specific study area networks will discourage investment in at least some of the affected rural networks.

For example, assume that Company A has long owned and operated a 2,500-line telephone company in a ranching portion of eastern Colorado. Further assume that Company A in 1994 acquired Company B, a separate 500-line telephone company serving an isolated mountain area in western Colorado, and that it retained Company B's employees and has operated its Company B subsidiary since that time as a separate network and study area. Company A and its Company B subsidiary currently receive separately calculated Federal universal service support based upon their own separate costs, and have used that support to invest in the infrastructure necessary to provide their rural customers with affordable services reasonably comparable to those available in urban areas. However, if the Company A and Company B study areas are consolidated, they will be treated as a single 3,000-line "study area" having some sort of amalgamated "costs" that reflect neither those of the ranching area nor those of the mountain area. Under such circumstances, Company A may well receive "consolidated" Federal support that differs from the aggregate of the amounts formerly received by Company A and Company B. How will Company A's owners and lenders evaluate such "consolidated" support when considering potential infrastructure investments and upgrades for the ranching network and for the mountain network? If the "consolidated" support is less that the current aggregated amount and if the ranching area is deemed to have better cost recovery potential, the likely result may be a significant decrease in investment in the mountain network where universal service needs may be the greatest.

B. Reclassification of "100,000 Line" Rural Carriers Will Discourage Rural Investment

The state proposal to move all rural carriers serving 100,000 lines or more within a state to the High Cost Model applicable to the RBOCs and other large "non-rural" carriers will likewise discourage investment. Moreover, it will improperly disregard the statutory definition of "rural telephone company."

Section 3(37) of the Communications Act provides four alternative criteria for qualification and treatment of a "rural telephone company." If a "local exchange carrier operating entity" satisfies any one of these four criteria, it qualifies for statutory treatment as a "rural telephone company."

The provision of "telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines" constitutes one of these four alternative criteria. However, an entity also qualifies as a "rural telephone company" if: (1) it provides common carrier service to any local exchange carrier study area that does not include either any incorporated place of 10,000 inhabitants or more, or any territory included in an urbanized area; or (2) it provides telephone exchange service, including exchange access, to fewer than 50,000 access lines; or (3) it has less than 15 percent of its access lines in communities of more than 50,000 on the enactment date of the 1996 Act. It appears possible for an entity to qualify as a "rural telephone company" under either the "incorporated place – urbanized area" alternative or the "less than 15 percent of its access lines" alternative, even if it provides telephone exchange service to a study area with 100,000 or more access lines. Therefore, the state proposal is subject to appeal because it disregards three of the four potential criteria for qualification as a "rural telephone company," and would deny some qualified "rural telephone companies" access to the same Federal high-cost support mechanism applicable to other "rural telephone companies."

Moreover, the state proposal would transfer some rural telephone company study areas from the Federal rural high-cost mechanism that has been very successful in encouraging infrastructure investment to the Federal non-rural High Cost Model that has been much less successful. The losers will be the rural residents and communities served by rural telephone companies having study areas with 100,000 or more access lines.

As indicated above, the RBOCs and other large carriers serving rural and non-rural exchanges traditionally have not been inclined to make substantial upgrades to significant numbers of their rural exchanges. To date, the Federal high-cost support distributed via the High Cost Model to RBOCs and other large "non-rural" carriers does not appear to have significantly increased investment in their rural exchanges. It therefore does not make any sense to transfer rural telephone companies serving study areas with 100,000 or more lines from a Federal rural universal service mechanism that has encouraged and produced substantial rural infrastructure investment to a Federal "non-rural" mechanism that has not. The more effective means of satisfying the statutory goal of encouraging telecommunications investment is to study and develop ways to make the High Cost Model more effective in encouraging investment by large "non-rural" carriers in their rural exchanges, while allowing all rural telephone companies to continue to participate in the effective and successful Federal rural universal service mechanisms.

VI

Conclusion

Whereas changes will be necessary to sustain Federal high-cost universal service mechanisms, the proposed block grants and multiple state allocation/distribution mechanisms are not the appropriate means. First and foremost, they will not pass judicial scrutiny because they violate established administrative law prohibitions against Federal agency sub-delegation of decision-making authority to state and other outside entities, as well as established Tenth Amendment prohibitions against compelling States to administer Federal regulatory programs. Moreover, the multiple state mechanisms will: (1) create uncertainty and disruptions that will discourage investment in needed rural telecommunications infrastructure; (2) render universal service administration far more expensive and complex that the existing national system; and (3) cause universal service support to become insufficient for many small rural carriers. There are several better alternatives for controlling the size and growth of the Federal high cost program.

Likewise, the proposed consolidation of rural telephone company study areas and the proposed transfer of some "100,000-line" rural telephone companies to the High Cost Model developed for large carriers should be rejected. Both proposals would discourage and reduce investment in rural infrastructure. In addition, the High Cost Model proposal would be subject to appeal because it disregards the multiple statutory criteria for qualification as a "rural telephone company," and unreasonably treats some rural telephone companies different than others.

Respectfully submitted,

WESTERN TELECOMMUNICATIONS ALLIANCE

By Gerard J. Duffy
Gerard J. Duffy

Its Attorney

Blooston, Mordkofsky, Dickens,
Duffy & Prendergast
2120 L Street, NW (Suite 300)
Washington, DC 20037
Telephone: (202) 659-0830
E-mail: gjd@bloostonlaw.com

INDEPENDENT TELEPHONE AND TELECOMMUNICATIONS ALLIANCE

By David W. Zesiger/GUD
David W. Zesiger

Its Executive Director

Independent Telephone and
Telecommunications Alliance
888 16th Street, NW (Suite 800)
Washington, DC 20006
Telephone: (202) 355-1388
Email: dzesiger@itta.us

Dated: September 30, 2005