Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Comment Sought on Request for Universal	)	WC Docket No. 05-337
Service Fund Policy Guidance Requested by	)	WC Docket No. 06-122
the Universal Service Administrative Company	)	CC Docket No. 96-45

COMMENTS
of the
ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES
and the
WESTERN TELECOMMUNICATIONS ALLIANCE

I. INTRODUCTION & SUMMARY

The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO)[1] and the Western Telecommunications Alliance (WTA)[2] hereby submit these comments in response to the Public Notice issued in the above-captioned proceedings.[3] The Public Notice seeks comment on requested guidance from the Universal Service Administrative Company (USAC) on a number of Universal Service Fund (USF) policy issues.[4]

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[1] OPASTCO is a national trade association representing approximately 520 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. Almost all of OPASTCO's members are rural telephone companies as defined in 47 U.S.C. §153(37).

[2] WTA represents more than 250 rural telephone companies in 24 states west of the Mississippi River. On average, WTA members serve fewer than 3,000 customers, and fewer than 500 customers per exchange. Its members provide voice, broadband, video and wireless services in some of the highest cost and lowest density areas in the country with some of the most rugged terrain, harshest weather conditions and socioeconomic situations arguably making it the nation's most difficult areas to serve.

[3] *Comment Sought on Request for Universal Service Fund Policy Guidance Requested by the Universal Service Administrative Company*, Public Notice, WC Docket No. 05-337, WC Docket No. 06-122, CC Docket No. 96-45, DA 09-2117 (rel. Sep. 28, 2009) (Public Notice).

[4] USAC letter to Julie Veach, Federal Communications Commission (Aug. 19, 2009); USAC letter to Julie Veach, Federal Communications Commission (Aug. 21, 2009).

The Commission should clarify that section 54.202(e) of its rules was not intended to be applied retroactively to time periods prior to the rule's effective date. This rule established for the first time document retention rules specifically applicable to high-cost support recipients. It requires rural ILEC high-cost support recipients to retain certain documents that they were not previously required to retain, and which they may not have retained for the duration of time now required, or perhaps at all. The Commission should not now, more than a year and a half after this rule became effective, expect rural ILEC high-cost support recipients to have complied with this rule prior to its effective date. Moreover, there is no indication that the Commission intended section 54.202(e) to apply retroactively. The Commission should therefore state that no remedial action, including the recovery of support paid to these rural ILECs, can be taken for their failure to have complied with the rule prior to its effective date.

The Commission should also clarify its document retention rules, so that they can be better understood by both rural ILECs and the auditors contracted by the FCC Office of Inspector General (OIG). Rural ILECs have reported uncertainty regarding precisely what the Commission's document retention rules require, and this has been exacerbated by auditors' requests for documents that do not appear in any of the Commission rules or orders, or that rural ILECs do not keep in their normal course of business. Thus, clarification of the document retention rules will enable the OIG audits to proceed more smoothly and efficiently.

The Commission should clarify that rural ILECs designated as eligible telecommunications carriers (ETCs) are not required to individually list each of the existing supported services in their advertisements. Taken together, the existing supported services make up retail "local exchange service." It is this service, and not the individual supported services, that consumers expect to purchase from a local exchange carrier (LEC). Moreover, LECs do not sell the existing supported services separately. Therefore, requiring rural ILECs to advertise the individual supported services would only serve to suggest that they could be purchased separately when they cannot, leading to consumer confusion.

Finally, the Commission should clarify that income taxes attributable to the shareholders of S-corporation rural ILECs are properly included in the carriers' interstate revenue requirement and recoverable through the USF. State and federal income taxes are an expense that rural ILECs incur as part of providing communications services to their customers, and this expense should be recoverable regardless of their corporate form. In addition, the Commission has already approved a similar practice for cable companies, and it has also been recognized as appropriate by the Kansas Court of Appeals and the National Exchange Carrier Association (NECA).

II. THE COMMISSION SHOULD CLARIFY THAT SECTION 54.202(e) OF ITS RULES IS NOT APPLICABLE TO TIME PERIODS PRIOR TO THE RULE'S EFFECTIVE DATE

A. Rural ILECs should not be penalized by the loss of high-cost support through the retroactive application of the Commission's document retention rules

USAC has requested guidance from the Commission regarding universal service support recipients' "…failure to comply with the document retention requirements of Section 54.202(e),[5] even though this rule was not in effect for the time period being audited."[6] USAC also asks the Commission for guidance as to what, if any, remedial

[5] 47 C.F.R. §54.202(e).
[6] USAC letter to Julie Veach, Federal Communications Commission (Aug. 19, 2009), p. 4.

actions should be initiated against support recipients, including the potential recovery of support paid to these carriers.[7] The Commission should clarify that section 54.202(e) of its rules was not intended to apply retroactively to any transactions by rural ILEC recipients of high-cost support that occurred prior to the effective date of the rule. In addition, the Commission should state that no remedial action, including the recovery of support paid to these carriers, can be taken for their failure to have complied with the rule prior to its effective date.

When it was adopted,[8] section 54.202(e) established, for the first time, document retention rules specifically applicable to high-cost support recipients. This rule required rural ILEC high-cost support recipients to retain certain documents that they were not previously required to retain, and which they may not have retained for the duration of time now required, or perhaps not at all. The Commission should not now, more than a year and a half after this rule became effective, expect rural ILEC high-cost support recipients to have complied with this rule prior to its effective date. Prior to the adoption of section 54.202(e), rural ILEC recipients of high-cost support based their document retention policies on the Commission's rules that existed at the time. It is only fair to evaluate their use of high-cost support based on the rules that were in effect during the time period being audited.

[7] *Id*.

[8] Section 54.202(e) of the Commission's rules was adopted on August 29, 2007. *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, WC Docket No. 05-195; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6; *Rural Health Care Support Mechanism*, WC Docket No. 02-60; Lifeline and Link-Up, WC Docket No. 03-109; *Changes to the Board of Directors for the National Exchange Carrier Association, Inc.*, CC Docket No. 97-21, Report and Order, 22 FCC Rcd 16372, 16383-16384, ¶24 (2007) (Comprehensive Review Order). The Comprehensive Review Order stated that it was effective 30 days after publication in the Federal Register. *Id*., 22 FCC Rcd 16399, ¶62. Publication in the Federal Register occurred on September 24, 2007, and stated that section 54.202(e) would not be effective until approved by the Office of Management and Budget (OMB). 72 Fed. Reg. 54214 (Sep. 24, 2007). Notice of the OMB approval was published by the Commission in the Federal Register on January 31, 2008. 73 Fed. Reg. 5843 (Jan. 31, 2008).

Additionally, there is no indication in the FCC's 2007 Comprehensive Review Order that the Commission intended section 54.202(e) to apply on a retroactive basis. Had that been the case, the Commission would have certainly stated that intention. However, no such statement was made in the Order.

The Commission should also state that no remedial action, including the recovery of high-cost support, can be taken against rural ILECs for failure to have complied with section 54.202(e) for time periods prior to the effective date of that rule. For many rural ILECs, high-cost support comprises a significant portion of their cost recovery and enables them to provide their customers with high-quality services, including advanced services, that are reasonably comparable to those available in urban areas and at reasonably comparable rates. Retroactive application of section 54.202(e) would only serve to unfairly penalize the rural customers of those ILECs that high-cost support is intended to benefit.

Certainly, it is the Commission's duty to ensure accountability for how universal service support is used by all recipients, including rural ILECs. And, for rural ILECs, it is in their best interest to retain and make available to auditors and the Commission all of the documents required to demonstrate that they are using universal service support for the purposes for which it is intended. This is because the loss of universal service support as a result of not complying with the Commission's document retention rules would significantly hinder their ability to make network investments and provide high-quality service to their customers. However, it is patently unreasonable to expect rural ILECs to have complied with the existing document retention rules prior to their effective date.

B. The Commission should take this opportunity to clarify its document retention rules, so that they can be better understood by both rural ILECs and OIG-contracted auditors

As OPASTCO has discussed in prior comments,[9] rural ILECs have reported uncertainty regarding precisely what the Commission's document retention rules require. This uncertainty has been exacerbated by a large number of instances in which OIG-contracted auditors have requested documents that do not appear in any of the Commission's rules or orders, or that rural ILECs do not keep in their normal course of business. Thus, clarification by the Commission of its existing document retention rules would be helpful to both rural ILECs and the auditors contracted by the OIG.

An example provided by an OPASTCO and WTA member illustrates this issue. This carrier reported that an OIG-contracted auditor requested underlying invoices to support continuing property records (CPRs) for 2006 and 2007. The auditor and the carrier were unable to agree on the applicability of section 54.202(e) or the requirements of Part 32. The auditor ultimately found that the carrier failed to comply with a requirement in sections 32.12 and 32.2000 to maintain supporting documentation, including invoices prior to 2001. Yet, these rules contain no requirement that underlying invoices to support CPRs be retained. Moreover, despite the fact that the OPASTCO/WTA member did retain these invoices for seven years on their own accord, this was nevertheless deemed inadequate by the auditor who expected the invoices to be retained for ten years, with a reference to section 32.2000. However, section 32.2000 not only makes no reference to invoices, it does not require that <u>any</u> document be retained for ten years.

[9] OPASTCO comments, WC Docket No. 05-195 (fil. Nov. 13, 2008), pp. 9-10.

Therefore, one important step that the Commission should immediately take is to clarify that underlying invoices to support CPRs were not required prior to the adoption of section 54.202(e). As noted above, there is no such requirement in Part 32 of the Commission's rules. In fact, it would have made little sense for the Commission to adopt section 54.202(e), which requires the retention of invoices, had that requirement already existed in Part 32.

Additionally, the Commission should seek to clarify all of its document retention rules for the benefit of both rural ILECs and OIG-contracted auditors. The Commission's rules on the documents a universal service support recipient must retain, and the length of time they must be retained, are spread throughout Parts 54, 42, 32, and others. The Commission should prepare a comprehensive inventory of its document retention rules. This should include, for each rule, a detailed description of precisely what documents satisfy the particular rule. Also included should be the retention period for each document, including whether it must be retained permanently or can eventually be destroyed.

By ensuring that both high-cost support recipients and OIG-contracted auditors understand precisely the FCC's document retention requirements, rural ILECs will be better able to demonstrate that they have received the proper amount of high-cost support and that they are using it for its intended purposes. In addition, rural ILECs and OIG-contracted auditors will be better prepared prior to an audit being conducted, thus enabling the audits to proceed more smoothly and efficiently, to the benefit of both the OIG's and rural ILECs' limited resources.

III. THE COMMISSION SHOULD CLARIFY THAT SECTION 54.201(d)(2) OF ITS RULES DOES NOT REQUIRE RURAL ILEC ETCS TO INDIVIDUALLY LIST EACH OF THE EXISTING SUPPORTED SERVICES IN THEIR ADVERTISEMENTS

The Commission should clarify that section 54.201(d)(2)[10] of its rules does not require rural ILEC ETCs to individually list each of the existing supported services in their advertisements.[11] Taken together, each of the existing supported services enumerated in section 54.101(a)[12] make up retail "local exchange service," also commonly referred to as "local telephone service," or "local service." It is this service, and not the individual supported services, that consumers expect to purchase from a LEC; they do not expect these carriers to make available any of the existing supported services individually. For example, consumers do not expect to be able to purchase "dual tone multi-frequency signaling or its functional equivalent" from a LEC without also purchasing "voice-grade access to the public switched network" and "local usage." Moreover, LECs do not sell the existing supported services separately because, for the most part, they are actually features and functions that collectively make up retail local exchange service. Also, because the supported services are not sold separately, many do not have an individual price, making it impossible to advertise the "charges therefore" as the rule requires. Consumers are already well aware of the features and functions included in retail local exchange service. Therefore, requiring rural ILECs to advertise the individual supported services would only serve to suggest that they could be purchased separately when they cannot, leading to needless consumer confusion.

[10] 47 C.F.R. §54.201(d)(2).
[11] USAC letter to Julie Veach, Federal Communications Commission (Aug. 21, 2009).
[12] 47 C.F.R. §54.101(a)(1)-(a)(9).

If the Commission nevertheless determines that rural ILECs' advertisements must include each of the existing supported services listed in section 54.101(a), it should state that this requirement only applies on a going-forward basis. As discussed above, given the way these "services" are sold as a package and not individually, it is reasonable for rural ILEC ETCs to have concluded that advertising them individually would confuse consumers. Moreover, because section 54.201(d)(2) does not clearly specify the exact content of advertisements, it is reasonable for these carriers to have designed their advertisements in a manner they believe is most effective for their customer base. Finally, the very fact that USAC has requested clarification from the FCC regarding section 54.201(d)(2) demonstrates that the exact requirements of the rule are unclear. Therefore, it would be inappropriate to initiate recovery action against rural ILEC ETCs for their reasonable interpretation of an ambiguous rule.

IV. THE COMMISSION SHOULD CLARIFY THAT INCOME TAXES ATTRIBUTABLE TO THE SHAREHOLDERS OF S-CORPORATION RURAL ILECS ARE PROPERLY INCLUDED IN THE CARRIERS' INTERSTATE REVENUE REQUIREMENT AND RECOVERABLE THROUGH THE USF

The Commission should clarify that income taxes attributable to the shareholders of rural ILECs organized pursuant to Subchapter S of the Internal Revenue Code[13] (S-corporations) are properly included in the carriers' interstate revenue requirement and recoverable through the USF.[14] State and federal income taxes are an expense that rural ILECs incur as part of providing communications services to their customers, and this expense should be recoverable regardless of their corporate form. In addition, the

[13] *See generally*, I.R.C. §§1361-1379.
[14] USAC letter to Julie Veach, Federal Communications Commission (Aug. 19, 2009), pp. 5-6.

Commission has already approved a similar practice for cable companies, and it has also been recognized as appropriate by the Kansas Court of Appeals and NECA.

Rural ILECs organized as S-corporations, "…pass corporate income, losses, deductions and credit through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates."[15] Thus, S-corporation rural ILECs do not avoid the payment of income tax. They are simply paid by the shareholders instead of directly by the corporation with the income that the corporation passes through to them.

The Commission should therefore clarify that all rural ILECs, regardless of corporate form, can recover the costs they incur in paying income taxes by including this expense in their interstate revenue requirement. To begin with, the Commission has previously determined that cable companies organized as S-corporations could include income taxes in their revenue requirement calculations. In approving this practice, the Commission reasoned that it should "…design an income tax treatment that permits recovery of income taxes regardless of the form of ownership of the regulated cable service enterprise."[16]

This practice also finds support in a Kansas Court of Appeals decision that addressed the issue of whether income taxes paid by the shareholders of S-corporations were a "cost of service" and thus recoverable from ratepayers. In approving this practice,

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[15] *See*, http://www.irs.gov/businesses/small/article/0,,id=98263,00.html

[16] *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, MB Docket No. 93-215, *Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, CS Docket No. 94-28, Report and Order and Further Notice of Proposed Rulemaking (rel. Mar. 30, 1994), ¶138.

the Kansas Court of Appeals correctly stated that, "…regardless of who paid, the taxes were on the income of the utility and were 'inescapable business outlays.'"[17]

In addition, NECA has permitted S-corporation carriers participating in its access revenue pools to receive income tax reimbursement.[18] With their small staffs and limited resources, rural ILECs often look to guidance from NECA regarding issues such as this, especially in instances where the Commission's policies are unclear.

Furthermore, a similar practice has also been approved by the Federal Energy Regulatory Commission (FERC) for regulated utilities organized as partnerships.[19] In doing so, the FERC rejected the argument that because a utility is owned by a partnership, it did not pay taxes. The FERC concluded that while the partnership itself did not pay taxes, the owners did, and therefore "…the taxes paid by the owners of the [partnership] are just as much a cost of acquiring and operating the assets of that entity as if the utility were owned by a corporation."[20]

A rural ILEC's choice of corporate form is based on a number of different factors and may include, among many other things, state corporate and estate laws, and state and federal income tax laws. Rural ILECs should have the freedom to balance these factors and choose the corporate form that best suits the interests of their owners and shareholders, and which allows them to most efficiently provide services to their customers. This choice should not be influenced by an artificial distinction that allows only corporations of a certain type to recover the significant and inescapable cost of state

[17] *Greeley Gas Co. v. Kansas Corporation Commission*, 15 Kan. App. 285, 807 P. 2d 167 (1994).
[18] NECA Cost Issues Manual, Section 3.1, Income Tax Treatment of Subchapter S Corporations, Partnerships and Certain Limited Liability Companies (Dec. 2008).
[19] Federal Energy Regulatory Commission, Policy Statement on Income Tax Allowances, 111 FERC ¶61, 139 (May 4, 2005).
[20] *Id*.

and federal income taxes. Therefore, state and federal income taxes should be permitted to be included in rural ILECs' interstate revenue requirements and recoverable through high-cost universal service support regardless of their corporate organization.

Nevertheless, should the Commission determine that income taxes are not recoverable in S-corporation rural ILECs' interstate revenue requirement, it should state that this only applies on a going-forward basis. To begin with, the very fact that USAC has requested clarification from the FCC regarding this practice demonstrates that the policy on this issue is not clear. And, considering the Commission's policy regarding S-corporation cable companies, along with NECA's treatment of its S-corporation pool members, it was reasonable for S-corporation rural ILECs to conclude that these expenses were properly included in their interstate revenue requirement. It would therefore be inappropriate for the Commission to take recovery action against these carriers.

V. CONCLUSION

The Commission should clarify that section 54.202(e) of its rules concerning document retention was not intended to be applied retroactively to time periods prior to its effective date and that no remedial action, including the recovery of support paid to rural ILECs, can be taken for failure to have complied with the rule prior to its effective date. The Commission should also seek to clarify all of its document retention rules, so that they can be better understood by both rural ILECs and the OIG-contracted auditors.

The Commission should clarify that section 54.101(d)(2) of it rules does not require rural ILEC ETCs to individually list each of the existing supported services in their advertisements. Requiring rural ILECs to advertise the individual supported services would only serve to suggest that they could be purchased separately when they cannot, leading to consumer confusion.

Finally, the Commission should clarify that income taxes attributable to the shareholders of S-corporation rural ILECs are properly included in the carriers' interstate revenue requirement and recoverable through the USF. State and federal income taxes are an unavoidable expense that rural ILECs incur as part of providing communications services to their customers, and this expense should be recoverable regardless of their corporate form.

Respectfully submitted,

**ORGANIZATION FOR THE
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October 28, 2009

CERTIFICATE OF SERVICE

I, Brian Ford, hereby certify that a copy of the comments by the Organization for the Promotion and Advancement of Small Telecommunications Companies and the Western Telecommunications Alliance was sent via electronic mail, on this, the 28th day of October 2009, to those listed on the attached sheet.

By: /s/ Brian Ford
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SERVICE LIST
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