Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92

COMMENTS

of

NORTHERN TELEPHONE COOPERATIVE, INC.

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Introduction and Summary

The Federal Communications Commission's (Commission) NPRM[1] in the above-captioned proceeding requests comment on proposed rules intended to modify the existing rules on the Universal Service Fund (USF) and Intercarrier Compensation (ICC).

Northern Telephone Cooperative, Inc. (Northern) is a rural telecommunications provider headquartered in Sunburst, Montana. Northern serves 1,575 voice access lines and 681 broadband customers scattered across a geographic area of roughly 3,000 square miles in north central Montana along a rugged, sparsely populated stretch of the US/Canadian border. Northern serves the easternmost portions of the Blackfeet Nation and extends hundreds of miles to the east. The cooperative serves only a few small communities, the largest of which is Sunburst with just over 300 residents. The remainder of Northern's customers are scattered almost uniformly across the vast expanses of its service area. The larger communities in the area such as Cut Bank (with a population of approximately 3,153) and Shelby (with a population of approximately 3,523) are served by Qwest. The nearest significant population centers are: Great Falls, Montana, with a population of just over 59,300, one hundred thirteen miles to the south of Sunburst; Kalispell, Montana, with a population of just over 21,600, one hundred eighty-four miles to the west; and, Lethbridge, Alberta, Canada, with a population of just over 74,000, seventy-five miles to the north.

Despite being faced with the well-known challenges of great distances and low customer densities, Northern is committed to working diligently to provide the broadband services its

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[1] *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13 (rel. Feb. 9, 2011) (*NPRM*).

customers need and deserve. All of Northern's customers have been able to enjoy the benefits of DSL for several years now (although not all subscribe to the service). In addition, the cooperative works closely with area schools and other anchor institutions to ensure they are provided with state-of-the-art voice and data communications capabilities. Northern also serves several border stations on the US/Canadian border providing voice and data services to various federal agencies such as the Department of Homeland Security and the US Border Patrol.

Like others around the country and around the world, the lives of rural Montanans are becoming increasingly enriched by the ability to engage in the evolving plethora of on-line activities such as e-commerce, telemedicine, entertainment, distance learning, e-government, etc. While DSL is still able to meet the network requirements of most of these applications, bandwidth demands are rapidly increasing to levels that will likely eventually exhaust DSL's technological capacity. Accordingly, Northern Telephone is diligently working to replace its aging copper lines with high-capacity fiber optic lines, a costly process that will take years to complete. Absent the cost-recovery mechanisms inherent in USF and ICC, or replacement mechanisms, this upgrade may never occur.

Northern Telephone submits these comments on the proposed rules intended to modify the FCC's existing rules on the USF and ICC mechanisms.

The following characteristics are true of Northern:

- As a Carrier of Last Resort, Northern is committed to providing telecommunications service to all requesting customers within its service territory.

- Northern is the Eligible Telecommunications Carrier (ETC) determined by the Montana Public Service Commission to provide universal service within the company's designated service territory.

- Northern receives High Cost Support from the Federal Universal Service Fund. This support totaled $1,462,104 in 2010 and comprises over 43.8% of Northern's revenues in 2010. Support came from the following sources:

    - High Cost Loop Support (HCLS) $728,862
    - Interstate Common Line Support (ICLS) $606,450
    - Local Switching Support (LSS) $126,792

- Northern generates substantial revenues from providing intrastate switched access services. In 2010 intrastate switched access revenues totaled $745,409.

- Northern provides voice and broadband services to schools, libraries, rural health care facilities, governmental agencies, and other anchor institutions within its service territory.

- Northern is one of the largest employers in its rural service territory, providing good jobs and financial stability to north central Montana. In 2010, Northern employed 13 full-time people throughout the year as well as several part-time college-aged workers to supplement its construction crew during the construction season. The cooperative's combined payroll and benefits totaled $1,388,909.

- Northern has deployed substantial financial and human resources to provide voice and broadband services under the existing rate of return rules prescribed by the FCC. In 2010, Northern had:

  - Regulated rate base $6,704,716
  - Net income $613,555

- Northern would not have had the financial resources to deploy and maintain either voice or broadband services without rate of return regulation and the support of the Universal Service Fund.

In these comments, Northern outlines the impacts that adoption of the short term USF and ICC rules, as written in the NPRM, would have on its financial results.

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I. Analyses Performed by Northern

In order to provide relevant financial context to the FCC in these comments, Northern engaged Moss Adams LLP[2] to perform a detailed financial analysis of the impacts of the NPRM. Their analysis primarily focused on the impacts of the proposed rules identified in Appendices A-C of the NPRM, which outline short term modifications to Universal Service Funding. They also analyzed the potential impacts of shifting intrastate access rates to an average interstate

[2] Moss Adams LLP (Moss Adams) is the 11th largest accounting and consulting firm in the United States, with more than 225 partners and 1,800 staff. Moss Adams' Telecom Group has served the telecommunications industry since 1957. Today, they provide audit, tax, and consulting services to more than 80 small and mid-sized telecommunications carriers throughout the United States and its territories.

switched access rate[3] or $0.0007. These analyses were performed using information from Northern's recently submitted 2011 National Exchange Carrier Association (NECA) cost study forecast, which is utilized by NECA in establishing tariff rates for its annual access tariff filing with the FCC, as well as other information generally available from Northern. The following assumptions were used in the analysis of the impacts of these proposed changes in USF support and intercarrier compensation:

- 2011 forecasted costs were held constant for the 4 year analysis (2011 – 2014). Given the uncertainty in regulation and drastic reductions in USF support proposed in the NPRM, Northern has remained steadfast in its endeavor to replace its aging copper plant with high-performance fiber optic lines. However, Northern is reluctant to seek debt financing for such activities. Although debt financing could definitely quicken the timeframe for extending fiber plant ever closer to each customer location throughout Northern's service area, the increasing uncertainty, especially over the future of the USF and ICC mechanisms, raises significant concerns about Northern's ability to repay such loans.

- All proposed changes to the calculation of High Cost Support were analyzed on an individual and aggregate basis. For example, for High Cost Loop Support, Moss Adams individually calculated the impacts of the phase out of support for Corporate Operations Expense and the reduction in support from 65% and 75% to 55% and 65%, and then calculated the combined impacts of these proposals.

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[3] The interstate switched access for each company varies based on participation in the National Exchange Carrier Association (NECA) FCC Tariff No. 5, NECA rate band, and transport miles and billing percentages included in the calculation of the composite rate. These composite switched access rates range from $0.010598 to $0.099349 per minute of use.

- For ICLS, Moss Adams performed a standalone analysis of the impacts of phasing out support for Corporate Operations Expense without considering the impact that changes to LSS have on the calculation of ICLS.[4] In addition, Moss Adams performed an analysis that included both the impacts of phasing out support for Corporate Operations Expense and the impacts of changes to LSS.

- Intrastate switched access minutes of use were held constant at their 2010 levels. While access minutes have been steadily declining, it was assumed that minutes will stabilize if the switched access rates decline to a composite interstate rate or $0.0007, and these savings are passed on to consumers by interexchange carriers.

- Voice access lines were held constant over the life of the analysis. While Northern has generally lost access lines over the past several years, it is difficult to forecast the level of continuing decline. Maintaining consistency is a conservative approach, which may actually understate the overall negative financial impacts of the NPRM over the life of the analysis.

- Beyond intrastate switched access, all intrastate revenues were held constant over the life of the analysis. This includes local service revenue, special access revenue, and state universal service funding. Again, the conservative approach taken may actually understate the overall negative financial impacts of the NPRM over the life of the analysis.

[4] Part 69.306(d)(2) of the FCC's rules requires a shift of the local switching revenue requirement (typically 30%), after the local switching revenue requirement has been reduced for LSS, to the common line revenue requirement. As a result, reductions in LSS will increase the local switching revenue requirement. This increased local switching revenue requirement is then shifted (30%) to the common line revenue requirement. The increase in the common line revenue requirement increases the amount of ICLS necessary to recover the common line revenue requirement.

Using a wide variety of data and the assumptions identified above, the following analyses were performed based on the 2011 NECA forecast data and actual 2010 financial results:

- The effect of phasing out support for Corporate Operations Expense over 3 years (2012-2014) on High Cost Loop Support (HCLS).
- The effect of phasing out support for Corporate Operations Expense over 3 years (2012-2014) on Interstate Common Line Support (ICLS).
- The effect of phasing out support for Corporate Operations Expense over 3 years (2012-2014) on Local Switching Support (LSS).
- The effect of reducing the HCLS support levels from 65% and 75% to 55% and 65% at once, starting in 2012.
- The effect of phasing out SNA over a 4-year period (2012-2015).
- The effect of phasing out LSS over a 3-year period (2012-2014).
- The effect of capping total High Cost Support (HCS) at $3,000 per line per year.
- The effect of transitioning intrastate switched access rates to the composite interstate switched access rate or $0.0007 per minute of use.[5]
- The combined effect of these proposed rule changes on net income.

[5] While there is a proposed calculation of support under Phase 2 of the Connect America Fund (CAF) that could include recovery of certain lost intrastate revenues, the NPRM does not ensure that this intrastate revenue loss will be recovered through the CAF or some other mechanism. As a result, Moss Adams included the proposed reductions in intrastate access revenues as potential lost revenues under the NPRM.

- The combined effect of these proposed rule changes on local customer rates.[6]

II. Financial Results and Findings of Moss Adams' NPRM Analysis

The results of the analyses and assumptions outlined above can be summarized for Northern as follows:

- The phase out of support for Corporate Operations Expense alone[7] reduces HCLS by $294,196, ICLS by $118,690, and LSS by $9,130 for a total impact of $422,016. This is a reduction in total High Cost Support of 28.21% over 3 years.

- The reduction in HCLS support from 65% of the Study Area Cost Per Loop (SACPL) above 115% of the National Average Cost Per Loop (NACPL) up to 150% of the NACPL and 75% of the SACPL above 150% of the NACPL to 55% and 65% respectively, alone reduces HCLS by $114,369. This is a reduction in total High Cost Support of 7.6% over 3 years.

- The phase out of LSS eliminates support of $75,497. This is a reduction in total High Cost Support of 5.0% over 3 years.

- The overall result of the proposed USF rule changes is a reduction in net income of $541,301, from $613,555 to $72,254. In addition, the return on regulated rate base declines precipitously from 9.15% to 1.08%.[8]

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[6] Presumably, increases in local rates will be the only way to recover lost USF revenues and potentially lost intrastate access revenues, as it is not clear that the Connect America Fund (CAF) will cover lost intrastate revenues.

[7] This does not include the impact of any other proposed rule changes.

[8] The interstate rate of return authorized by the FCC is 11.25%. Intrastate rates of return vary by state and by company, but typically fall in the range of 8% to 12%.

- The reduction of intrastate switched access rates to a composite interstate switched access rate or $0.0007 per minute of use reduces intrastate revenue by $548,403 and $741,839 respectively. This is a reduction of 73.57% and 99.52% respectively.

- The combined impact of these proposed rule changes has a devastating impact on the company's net income. In 2010, net income was $613,555. The result of the proposed USF rule changes, and intrastate switched access rates at the composite interstate rate, is a reduction in net income of $1,089,704 for a resulting net loss of $476,149. If intrastate switched access rates are further reduced to $0.0007, and there is no support for this lost revenue under the CAF or some other mechanism, net income is reduced by $1,283,140 for a resulting net loss of $669,585.

- As a result of these substantial reductions in revenue, with no apparent offset in support, Northern would have to raise end user rates, or reduce costs, to maintain long term financial viability. Northern's residential rates (excluding the Federal Subscriber Line Charge) for supported voice services currently average $9.60 per line per month today. In order to recover an amount equal to the lost High Cost Support, Northern would need to increase end user rates by an estimated $28.64 per line per month. This is an increase of more than 298.34% from today's average rates.

- If the CAF, or some other mechanism does not support lost intrastate access revenues, end user rates would need to increase by an additional $29.02 with intrastate access rates reduced to the composite interstate rate per minute of use, or $39.25 with intrastate access rates reduced to $0.0007 per minute of use. Combined with the reductions in High Cost Support outlined above, end user rates would need to increase by as much as $67.89 to recover the lost revenues. This is an increase of more than 707.20% and brings the average rate for basic local service to a staggering $77.49 per month, not including the Federal Subscriber Line Charge, calling features, and taxes and surcharges.

III. Northern's Ability to Generate Cost Savings Through Increased Efficiency

Northern does not have the ability to generate significant cost savings through increased efficiency. As the Carrier of Last Resort, and as a cooperative, we are committed to providing service to all requesting customers. As a result of this commitment, our ability to reduce capital investments is limited. If a customer requests service, we must build the facilities to that customer, pursuant to applicable tariffs. In order to meet the expectations of our customers that we provide services that are reasonably comparable to those available in urban areas, we must continually maintain and upgrade our network.

In addition to the capital costs discussed above, many of our operating expenses are fixed, and certainly are not discretionary as the NPRM would suggest. The majority of our operating expenses are driven by employee salaries and benefits and depreciation expense. These employees install service, maintain and repair the network, provide customer service, and perform administrative and management functions.

Certainly the installation of service and maintenance and repair of the network are not discretionary functions. In order to reduce these costs, we would need to reduce staff, which would in turn negatively affect the quality of service that we are able to provide our customers.

Customer service representatives are responsible for assisting customers with: understanding and ordering services; solving service problems; understanding and paying bills;

and, many other customer facing functions. If forced to reduce customer service-related costs, we would need to reduce staff, which would in turn negatively affect our ability to assist customers in understanding services and rates.

Corporate operations expenses primarily include administrative functions, such as: regulatory accounting and auditing; legal and regulatory requirements; general management; and other administrative requirements. Many of these functions are mandated by the Montana Public Service Commission and/or the FCC, or lenders that provide necessary capital to build the network. In order to reduce these costs significantly, we would need to reduce staff, which in turn would negatively affect our ability to manage the company and to meet many of our regulatory obligations and our customers' expectations.

Our staffing levels are designed to maintain compliance with all regulatory and customer service standards, including meeting customer and network demand and allowing for reasonable work schedules, including sick and vacation time. We believe that it would be very difficult, if not impossible, to significantly reduce these expenses, while still maintaining the quality of service, customer responsiveness and meet regulatory requirements mandated by regulators, and more importantly, to continue to meet or exceed customer expectations.

IV. Conclusions

Given the realities of Northern's service area, there simply is no viable business case to support even the ongoing maintenance of Northern's network, not to mention network upgrades, without ongoing sufficient and predictable cost recovery assistance. In other words, the costs of providing communications services in Northern's service area that are comparable to services available in urban areas are so great that recovering those costs solely, or even substantially from

Northern's customers would result in prices so excessively high they would simply be unaffordable. This would violate the policy (as well as federal law) that requires not only comparable services be available to all Americans, but also at comparable prices. This policy is grounded in the fundamental belief that the value of the nation's communications network is optimized only if all Americans are connected to the network.

Based on the analysis of the NPRM performed by Moss Adams, Northern Telephone Cooperative (which has served north central Montana for 57 years) would enter a death spiral, strangled by the need for rapidly increasing local rates and a resulting rapidly declining customer base.

There are simply too few cost-cutting measures available that would enable Northern Telephone to withstand the reductions in cost recovery that would stem from the proposed USF and ICC reforms. Northern Telephone has not engaged in practices that result in the recovery of excessive capital and operating expenses. Increasing Northern's local rates to offset the effects of the reforms would render voice and broadband services unaffordable to Northern's customers.

Northern Telephone urges the Commission to refocus the rulemaking process on areas that can be identified as wasteful or inefficient rather than jeopardizing a valuable, proven program with the purpose of reducing its size.

RESPECTFULLY SUBMITTED

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