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 an 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

COMMENTS OF HARGRAY TELEPHONE COMPANY

The Commission received a large volume of comments in this proceeding identifying numerous issues and offering the Commission an even greater number of perspectives on the issues raised. As a rate-of-return carrier that serves portions of Jasper and Beaufort Counties in South Carolina, Hargray has given careful consideration to many different aspects of the proposals for comprehensive reform of the Universal Service Fund ("USF") and Intercarrier Compensation ("ICC") systems, currently under consideration by the Commission. Rather than add its voice to the masses with respect to each element of these reform proposals, Hargray is focusing on a narrow set of issues. *First*, to the extent the Commission adopts the proposal put forth by the United States Telecom Association ("USTA" and the "USTA Proposal"), Hargray urges the Commission to address an unintended consequence of the proposal and give rate-of-return companies a practical path to opt into price cap regulations in the future—a goal also shared by the Independent Telephone & Telecommunications Alliance ("ITTA")and FairPoint Communications, Inc. ("Fairpoint"). Specifically, the Commission should adopt a rule that allows rate-of-return carriers to elect into price cap regulations without altering their high cost support status or intercarrier compensation path.

Hargray also has two points with respect to the mechanics of calculating support for rate-of-return carriers under the USTA Proposal: the Commission should not reduce the interstate rate-of-return that carriers are able to receive to below 11.25 percent; and the Commission should include an inflation adjustment factor in the cap for corporate operations expenses. While the USTA Proposal has some workable elements and should be commended in a number of respects, the proposal goes too far in the direction of sacrificing the ability of rate-of-return carriers to provide their consumers affordable and reliable communications services.

I. THE COMMISSION SHOULD ADDRESS THE ABILITY OF RATE-OF-RETURN CARRIERS TO ELECT INCENTIVE-BASED REGULATION IN THE FUTURE.

Hargray agrees with comments filed by ITTA that "[s]traightforward, easy-to administer rules should be adopted to govern how a [rate-of-return] carrier will be treated should it decide to change its regulatory status during the pendency of the intercarrier compensation transition period or the life of the CAF."[1] Specifically, Hargray urges the Commission to preserve an avenue for rate-of-return carriers to convert to price cap status while continuing to

[1] Comments of Independent Telephone & Telecommunications Alliance, at 8 (Aug. 24, 2011).

receive high cost support and intercarrier compensation. The Commission can achieve its universal service and intercarrier compensation reform goals without necessarily linking all regulatory decisions to the status of the carrier.

The Commission has long recognized that there are major benefits to be gained from price cap regulation—namely incentives for carriers to become more productive, innovative and efficient.[2] However, the ABC Plan under consideration will have the practical effect of precluding rate-of-returns carriers from converting to price cap status.[3] In particular, there will be strong disincentives for carriers to adopt price cap regulation if the reform proposal creates an "all or nothing" approach whereby a carrier will have its high cost support reduced by virtue of conversion. The Commission has resisted such an "all or nothing" approach in the past, granting a number of requests in recent years for carriers to convert from rate-of-return to price cap status while continuing to receive high cost support.[4]. As Fairpoint explained in its May 23, 2011 Reply Comments, the Commission's current approach—allowing carriers that have voluntarily moved to price cap regulation to retain their high cost support—has a number of benefits "not only for the carriers but for consumers and the Commission."[5] If price cap conversion is an "all

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[2] *Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, Order, WC Docket No. 07-171, 23 FCC Rcd 5294 (2008) ("*Windstream Price Cap Order*").

[3] *See* Letter from Robert W. Quinn, Jr., AT&T, Steve Davis, CenturyLink, Michael T. Skrivan, FairPoint, Kathleen Q. Abernathy, Frontier, Kathleen Grillo, Verizon, and Michael D. Rhoda, Windstream, to Marlene H. Dortch, FCC, WC Docket No. 10-90, et al. (filed July 29, 2011) (the "ABC Plan").

[4] *See, e.g., Windstream Price Cap Order*; *Petition of Puerto Rico Telephone Company, Inc. for Election of Price Cap Regulation and Limited Waiver of Pricing and Universal Service Rules; Consolidated Communications Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief; Frontier Petition for Limited Waiver Relief upon Conversion of Global Valley Networks, Inc., to Price Cap Regulation*, Order, WC Docket Nos. 07-292, 07-291, 08-18, 23 FCC Rcd 7353 (2008) ("*Combined Price Cap Order*").

[5] *See* Reply Comments of FairPoint Communications, Inc., at 9-10 (May 23, 2011) (describing the numerous benefits of an approach whereby carriers can convert to price cap without losing their ICLS support and proposing that the Commission allow ROR carriers to convert to price cap regulation for its (continued…)

or nothing" proposition with respect to the availability of high cost support, there will be a significant deterrent for any carrier contemplating price cap conversion. Indeed, Consolidated Communications Holdings Inc. ("Consolidated"), a recently converted carrier, has expressed concern about how its customers and service will be impacted under the ABC Plan if it is not permitted to retain ICLS support.[6] Consolidated's concern suggest the sensitivity of rate of return carriers that are considering conversion with respect to the continued availability of high cost support. Moreover, the aggressive elimination of intercarrier compensation as to price cap carriers proposed by the ABC Plan represents an additional and significant disincentive to price cap elections.[7]

These deterrent effects will be magnified by the substantial degree of uncertainty that carriers will face with respect to the proposed cost model under the ABC Plan. As a number of commenters noted, the cost model was designed by and for larger mid-sized carriers and very large carriers, and rate-of-return carriers have not had a meaningful opportunity to evaluate the sufficiency and predictability of support under the cost model.[8]

Finally, the proposed budget allocation for price cap carriers and rate-of-return carriers are static, and there is no mechanism to address the possibility that one or more rate-of-return carriers may elect to opt into incentive-based regulation. The kind of sizable conversions

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interstate rates and continue to receive ICLS at the prior year's levels). While Hargray's proposal differs somewhat from FairPoint's proposal insofar as Hargray would not require carriers to make an election as of a certain date in order to retain their ability to obtain support calculated under the current rules, Hargray and FairPoint agree that the Commission must address the ability of rate-of-return carriers to convert while retaining high cost support.

[6] *Id.*

[7] *See* ABC Plan.

[8] *See, e.g., Comments of Consolidated Communications Holdings Inc.*, at 5. The Commission ought to provide carriers a meaningful opportunity for notice and comment with respect to the cost model, and, even then, the cost model will be untested and the source of uncertainty for rate of return carriers.

witnessed in recent years by Windstream, Consolidated, Puerto Rico Telephone, and others likely will be *opposed* in the future by the price cap companies (and possibly the Commission) since under the current system any conversion would result in a new carrier dipping into their support bucket. In addition, there will be a significant disincentive for current rate-of-return carriers to elect price cap regulation in the future since such carriers would be electing into a finite pool of support and thus a smaller share of the pie than they might otherwise receive.

For these reasons, Hargray urges the Commission to ensure that it appropriately addresses the ability of rate-of-return carriers to elect into an incentive-based system of regulation without altering their high cost support status or intercarrier compensation path. As Consolidated has explained in its comments in this proceeding, the ABC Plan presents a "one-size-fits-all" approach that "does not take account of [the] particular needs [companies that have recently converted to price cap regulation] for support, [thus jeopardizing its ability] to maintain existing networks and provide service to their customers at reasonable prices."[9] The ABC Plan likewise fails to address the service needs of carriers that might consider converting to price cap regulation in the future. This not only threatens to undermine long-standing Commission policies that favor incentive-based regulation, but also would eliminate a source of flexibility for rate-of-return carriers at a critical time of profound change in the USF system. Hargray thus urges the Commission to address the ability of those rate-of return carriers that may be in a position to convert to price cap to do so in the future. We proposed a specific rule change in our August 24 Comments in this proceeding that is premised on the current framework of the Commission's rules governing the USF and ICC systems. While we believe that this straightforward approach will continue to have merit, we recognize that the proposed reforms are

[9] *Id.*

likely to result in an overhaul of the existing rules, and we are not in a position to propose the necessary conforming changes to rules that are not yet written. However, we look forward to working with NECA and Commission staff to refine this proposed rule change.[10]

II. RATE-OF-RETURN CARRIERS ARE TAKING A SIGNIFICANT HAIR CUT UNDER THE USTA PROPOSAL.

While a number of interested stakeholders have made compromises in order to forge the consensus USTA Proposal, the framework places a disproportionate burden on rate-of-return carriers. This burden is significant and arguably jeopardizes the mandate that universal service provide a "specific, predictable and sufficient . . . mechanism[] to preserve and advance universal service."[11] To ensure that the program continues to satisfy this mandate, Hargray urges the Commission to make two important changes: the rate-of-return should remain at 11.25 percent and the cap on corporate operating expenses should be adjusted for inflation.

Rate-of-Return of 11.25 Percent. Under the existing USF system, rate-of-return carriers have the opportunity—not a guarantee—to earn up to 11.25 percent. The Commission has asked for comment about whether to reduce this to below 11.25. However, reductions in that rate below 11.25 percent would undermine settled expectations that are reflected in the marketplaces (as well as in loan agreements). Over the past decade, small carriers have invested billions of dollars in equipment and network infrastructure on the basis that they would be able to earn an 11.25 percent rate-of-return. Indeed, many small carriers have borrowed money from the Rural Utility Service and private lenders on the basis of a government-established 11.25 percent

[10] *See Comments of Hargray Telephone Company*, at 8.

[11] *See* 47 U.S.C. § 254(b)(5).

rate of return.[12] To reduce the rate of return now, after the capital has already been deployed, would undermine those expectations and investments in telecommunications infrastructure throughout the country.[13]

Rate-of-return carriers overwhelmingly have taken the position that an 11.25 rate of return is appropriate to ensure that the fund provides a "specific, predictable and sufficient . . . mechanism[] to preserve and advance universal service,"[14] and advance the National Broadband Plan's goals of truly universal broadband.[15] It is true that some carriers have indicated that as an absolute floor, they are willing to accept a 10 percent rate-of-return as one element in a comprehensive reform package.[16] However, this position under-appreciates the damage that a reduction in the rate from 11.25 percent to 10 percent will cause in the ability of rate-of-return carriers to raise funds for future investments. Smaller rate-of-return carriers simply do not have access to the low-cost capital that is accessible to larger companies, including many of the

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[12] *See Comments of Kansas Rural Independent Telephone Companies; State Independent Telephone Association; and Rural Telecommunications Management Council*, at 2 (August 24, 2011) ("Comments of KR ITC, et al") ("Retention of rate of return regulation for rural incumbent carriers is a critical component of assuring expanded access to broadband service. Many rural providers . . . have made significant investments to deploy broadband-capable facilities to much or all of their service areas. In most cases these investments have been possible only through assumption of long-term obligations. These obligations, in turn, have been possible only through reliance of both the lender and the borrower on continued specific and predictable universal service support.")

[13] *See id.* at 9-10.

[14] *See* 47 U.S.C. § 254(b)(5).

[15] *See, e.g., Comments of TDS Telecommunication Corporation,* at 3 (noting that a 10 percent rate-of-return "falls short in providing for the level of investment in rural broadband that ROR carriers . . . have advocated in this proceeding, and which is necessary to bring to fruition the vision of the National Broadband Plan for truly universal broadband").

[16] *Comments of National Exchange Carrier Association, Inc.; National Telecommunications Cooperative Association; Organization for the Promotion and Advancement of Small Telecommunications Companies; and the Western Telecommunications Alliance,* at 17 (August 24, 2011) (noting that Rural Associations took extraordinary step of agreeing to support 10 percent rate-of-return to forge a consensus framework and support it only as a transitional measure).

carriers that that took part in the USTA negotiations. Decreasing the rate-of-return to 10 percent will have a serious impact on the ability of smaller carriers to provide affordable and ubiquitous voice and broadband services.

Inflation-adjusted Cap on Corporate Operating Expenses. For the reasons submitted in our prior Comments in this proceeding, Hargray urges the Commission to tie the cap on corporate operating expenses to the pace of inflation. The USTA Proposal continues to require small carriers to spend vital resources on cost studies and consultants and related expenses, and companies might reasonably be expected to have to spend even more on corporate operations functions during the transition to the CAF. Especially if the Commission intends to use the corporate expense cap for additional purposes other than how it has been used in the past, the cap must be adjusted for inflation. Specifically, Hargray suggests that the Commission adopt an annual adjustment to the cap that reflects changes in the Consumer Price Index ("CPI") or the Gross Domestic Product—Price Index ("GDP-PI").

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There are numerous and complex issues raised in this proceeding, but the three issues that are identified in these Reply Comments are critical to ensure that existing rate-of-return have the support and flexibility to make good on the promise of universal service, both with respect to traditional voice services and the development of 21st century telecommunications services.

Respectfully submitted,

/s/

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