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
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

COMMENTS
of
CALAVERAS TELEPHONE COMPANY

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Introduction and Summary

The Federal Communications Commission's (Commission or FCC) *Report and Order and FNPRM*[1] in the above captioned proceeding requests comment on proposed changes to the existing Universal Service Fund (USF) and Intercarrier Compensation (ICC) mechanisms for rural rate-of-return carriers, among other issues. Specifically, the FCC requests comments on Sections XVII.A-K of the *FNPRM*, which address a wide variety of USF related issues.

Calaveras Telephone Company[2] (Calaveras) submits these comments for the FCC's consideration. Calaveras is a rural telecommunications provider serving 3,810 voice access lines and 2,264 broadband customers in the State of California. The following characteristics are true of Calaveras:

- Calaveras is the Carrier of Last Resort designated by the California Public Utilities Commission, which legally obligates the company to provide telecommunications service to all requesting customers within its service territory.

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

[1] *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, *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-161 (rel. November 18, 2011) (*Report and Order and FNPRM*).

[2] Calaveras Telephone Company is located in rural, central California in the foothills approximately 40 miles east of Stockton. The area's economy is driven primarily by agriculture and tourism, with several developments that cater to commuters from Stockton and neighboring towns and second homes for residents of the San Francisco Bay Area.

- Calaveras receives High Cost Support from the Federal Universal Service Fund. This support totaled $3,934,041 in 2010[3] and comprised over 43% of Calaveras revenues in 2010. Support came from the following sources:

    - High Cost Loop Support (HCLS) $2,043,669
    - Safety Net Additive (SNA) $148,428
    - Interstate Common Line Support (ICLS) $1,662,264
    - Local Switching Support (LSS) $79,680

- Calaveras generates substantial revenues from providing intrastate switched access and reciprocal compensation services. In 2010 intrastate switched access and net reciprocal compensation revenues totaled $350,839.

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

- Calaveras is one of the largest employers in the company's rural service territory, providing jobs and financial stability in rural foothill areas of central California. In 2010, Calaveras employed 42 people and provided combined payroll and benefits of $3,320,964.

- Calaveras has deployed substantial financial and human resources to provide voice and broadband services under the existing rate of return rules prescribed by the FCC and by

[3] 2010 revenues are used throughout these comments because final 2011 numbers are not yet known. We believe that 2010 revenues are reasonably representative of 2011.

the California Public Utilities Commission. In 2010, Calaveras had gross regulated investment of $31,058,274

- Calaveras 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 under the existing rules.

- Calaveras is very concerned with the potential financial implications of the *Report and Order and FNPRM* and the impact they will have on Calaveras' ability to continue to provide high quality voice and broadband services at the public interest standards established by the Commission.

In these comments, Calaveras outlines the impacts that adoption of the limitations on capital and operating expenses, as proposed in the *Report and Order and FNPRM*, would have on its financial results.

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COMMENTS
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I. Company Background and Unique Challenges

Calaveras Telephone Company (Calaveras) is located in rural, central California, in the foothills region of Calaveras County and approximately 40-60 miles east of the metropolitan areas of Merced, Modesto and Stockton. These three cities are among the five highest foreclosure capitals in the country. Calaveras County was recently ranked as the 19th worst economy in the entire country. California's economy is extraordinarily dismal, led by the collapse of the real estate economy, the bottom of which may not yet have been seen.

California's unemployment rate is about one third higher than the national average, and Calaveras County's is higher yet. California's tax rates are among the nation's very highest, for sales, income and gasoline. Studies have clearly demonstrated that excessively burdensome regulations have cost California well over three million jobs and cause billions in potentially unnecessary expenses every year. For example, one new regulation requires telecom construction projects to be shut down if there is even the forecast of – not actual – rain. Such uneven laws add millions to construction costs, and certainly detract from any potential productivity gains. More specifically, the extent of telecom regulation and regulatory engagement in California is extraordinarily high, with dozens of proceedings (some of which last fully five to ten years) ongoing throughout the year.

Copperopolis (population 2,363) is the largest of Calaveras' two exchanges and the area is severely impacted by the collapsed housing markets of the three cities, particularly Stockton. The idea of Copperopolis remaining a bedroom community for workers who were commuters to Stockton and Modesto has significantly faded. Further, the idea of Copperopolis being a real estate magnet for Bay Area refugees has also vanished in large part. These two critical factors formerly drove growth.

Early this century, Calaveras featured annual access line growth rates of 6-8%, and was faced with incredible needs to upgrade its network and build out new subdivisions throughout Copperopolis and the surrounding area. The trigger for the early broadband push began in earnest, with the need for an extensive array of digital loop carrier (DLC) sites shortening customer loops, greatly improving transmission quality and ultimately improving service reliability. Each of these DLC's required replacement of copper feeder routes with digital, fiber-fed solutions. Until July 31, 2006, the area featured phone banks at realtor offices, construction

general contractors and sub-contractors galore, mortgage brokers working out of their homes with 2nd and 3rd lines, and various other support businesses. All of those access lines have vanished with foreclosures, layoffs, businesses closing, property values plummeting by two thirds in many locations, and associated economic malaise.

Understand, though cattle can easily graze on nearby pastures, this difficult and rocky terrain, with poor soil conditions, is ideal for housing as opposed to paving over the rich soil of the nearby Central Valley (where Modesto, Merced and Stockton are located). Retaining that natural breadbasket to feed the Country is an important national treasure, coupled with revitalizing the foothill region as a prime location to grow housing starts (the California population continues to grow despite the horrible economy, and finding locations to put them all in crowded cities is a real issue).

Heavily punctuated by rock outcroppings, the hilly and generally uneven terrain proves difficult for telecom construction, with equal parts trenching and plowing likely, though both quite costly. There is significant open space and pasture/grazing lands between the spread out Copperopolis area and the somewhat distant Jenny Lind exchange area, located about 20 miles away. Jenny Lind is a much more compact service area, and has been severely impacted by job losses from Stockton commuters, up to 8% annual attrition rates the last several years. Combined, the overall Company service area comprises 250 square miles with an access line density of 15 per square mile. With extensive cable routes required for the many subdivisions and spread out nature of the territory, the route mile density of the area averages 6.5 access lines per mile of plant. It is worth noting that the extremely small town of Copperopolis actually consists of three different (business) locations, each about three miles from each other. There is the older historic district, then the market/shopping district separate—which used to house all of

the real estate sales offices, and finally the most recent (new) Copperopolis Town Square. All three areas are facing serious economic disruption in comparison to the booming years of 2000-2005. At 3,810 access lines, the company has lost 590 customers since the zenith recorded July 31, 2006.

Calaveras offers the typical array of voice and related services to its customer base, including virtually all of the popular custom calling features and voice mail. Its trouble index as submitted to the California PUC is impeccable, with 99% reliability factors. Virtually 100% of the customer base has access to broadband Internet service. Calaveras provides wholesale DSL capability through the NECA tariff. Affiliate CalTel Connections in turn provides retail DSL to the customer base with actual service penetration rates approaching 60%, the success in part driven by the above-cited access line attrition. Only recently has a second tier [6 Megabits] of bandwidth been offered. As a result of the placement of fiber-fed DLC's within 3,000-6,000 feet of most every customer location, CalTel currently can achieve the FCC's 4 Mbps downstream/1 Mbps upstream broadband standard in most areas served upon request.

Current year construction centers on completion of a long-delayed (420 days of environmental review) RUS/ARRA funded fiber optic cable project (award made in 2010) primarily serving the Poker Flat subdivision located about seven miles south of Copperopolis. In addition to the grant funding, substantial Company matching funds are required to supplement the RUS grant/loan funds. The RUS stipulated a formula that areas with very high construction costs must supply significantly higher percentages of matching funds in order to secure the grant. That was the case with Poker Flat, with very tiny lot sizes, minimal construction corridor, and very steep, rugged and rocky terrain. Calaveras was faced with 33-38 year old buried copper plant with no vacant duct for augmentation. Thus the fiber optic cable replacement involves

virtually 100% rock sawing of the network of winding subdivision roads, a significantly higher cost than if there had been road shoulders to utilize or spare duct capacity. It is anticipated that up to $3,000,000 will be expended in 2012 to complete—or substantially—complete the project.

In addition to the bandwidth-expanding project for Poker Flat, grant/loan and matching funds will also be spent on a new aerial toll route from the service territory to Stockton, which will benefit all customers and ultimately lead to lower transport costs. In addition to the above-cited environmental delays, which clearly increased corporate expenses and construction costs, delays in the delivery of fiber optic cable of up to ten months have greatly hampered both progress and cost efficiencies. For example, placement of duct promptly followed by blowing of fiber cable would normally be a simpler process with same crew and same proximity of effort. Instead, with fiber placement delayed another six to nine months after the duct placement, the project requires a completely separate construction pass and significantly redundant labor costs.

Calaveras' story isn't necessarily unique in the world of rural telecommunications, but it is an excellent example of the unique challenges faced in providing the universal service mandate in the most sparsely populated and difficult areas to serve in the country. We do not seek more than our fair share from universal service funding and intercarrier compensation, but we do insist that the FCC recognize the unique nature of rural rate-of-return carriers and ensure that we continue to recover our costs reasonably incurred in the provision of universal service. These comments focus in on just a couple of areas where we believe that the *Report and Order and FNPRM* may be failing rate-of-return carriers.

II. Analysis Performed by Calaveras

In order to provide relevant financial context to the FCC in these comments, Calaveras engaged Moss Adams LLP[4] to perform a detailed financial analysis of the potential impacts of the limitations on capital and operating expenses proposed in the *Report and Order and FNPRM*. This analysis primarily focused on the impacts of the proposed regression analysis identified in Appendix H to the *Report and Order and FNPRM*. This analysis was performed using Calaveras data used by, and provided by, the FCC in the development of its regression analysis. In doing so, Moss Adams recreated the regression analysis performed by the FCC and reproduced the same results. In addition, Moss Adams also utilized other information generally available from Calaveras in the analysis. The following comments include our overall assessment of the FCC's regression analysis and provide a summary overview of the financial impacts on Calaveras, including the impacts of changes in the analysis proposed by Calaveras.

III. The FCC's Regression Analysis Utilizes Incorrect Data

The census data that the Commission uses as inputs to its model in the *Report and Order and FNPRM* are subject to a substantial degree of error. In any model, where there are errors or inaccuracies in the inputs, those data flaws will also create errors or inaccuracies in the outputs of the model. The *Report and Order and FNPRM* relies on significantly flawed data, and therefore produces similarly flawed results.

Part of the input error is created by the Commission's use of the TeleAtlas tool to define study areas. While the Commission's model assumes Calaveras' study area encompassing 117.9

[4] 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.

square miles, Calaveras' actual study area encompasses approximately 250 square miles – an extraordinary error by any measure and one that is certain to produce a flawed result.

This is extremely significant to Calaveras. Prior to regression caps, 2010 Calaveras data at a national average cost per loop of $509.06, yielded estimated High Cost Loop Support (HCLS) of $2,220,470. The proposed regression caps, which included the incorrect square miles above, reduced HCLS to $2,020,439, a reduction of $200,031 or 9.9%. Increasing the square miles in the regression analysis to the actual of 250 results in HCLS of $2,125,145, an increase of $104,706, or 4.93%, over the capped amount. Should the Commission continue down this regression path, the data for Calaveras and all carriers needs to be accurate. Calaveras serves as an example that the census data which the Commission uses as inputs to its model are subject to a substantial degree of error, and therefore is not appropriately used to cap Calaveras' costs.

IV. The Model Does Not Yield Consistent Results for Similarly Situated Companies

In defining similarly situated companies, the FCC must consider factors that drive the true cost of loop facilities. Calaveras notes that the FCC's model used to perform the regression analysis did not take some of the primary drivers of loop costs into account, such as the length of loops – a major factor leading to high loop costs. In Calaveras' case, it has 6.5 access lines per mile of loop plant. The model also does not take into account the poor soil conditions and rocky terrain that Calaveras must build in, which often requires that rock to be cut or bored to bury cable plant. These conditions often cause significant delays and cost increases to place cable plant.

V. The FCC's Regression Analysis Does Not Consider the Impacts of Depreciation Reserve

The FCC's model used to perform the regression analysis does not take the depreciation reserve of the plant being limited into account; it is purely analyzed on a gross plant value. Companies like Calaveras deploy their network over time and, as a result, must regularly replace facilities as they are reaching the end of their useful life. In addition, they will continue to make the necessary network changes, which will require additional investment, to meet the Commission's 4 Mbps downstream/1 Mbps upstream broadband requirements. The regression model as proposed does not allow for this, and its failure to recognize the impacts of depreciation reserve is a significant flaw in the model.

VI. The Limitations Are Applied Incorrectly to the High Cost Loop Support Algorithm

Calaveras believes there are three accounting issues that must be addressed in the calculation and application of the proposed regression-based limitations. First, the High Cost Loop Support ("HCLS") data inputs ("data lines" or "DL") should be limited, not the outputs ("algorithm lines" or "AL"). Second, the limitations must take into account the impact of accumulated depreciation and other Part 32 accounts on the calculation of support. Third, the methodology used to calculate the limitations on depreciation expense must be modified.

Calaveras believes that the limitations should be applied to the HCLS data lines instead of the algorithm lines, which would allow the 26 step algorithm to work as designed. The current limitation of the algorithm lines does not account for the interrelationship between many of the data lines used in the calculation of support. It should be noted that all of the algorithm lines are calculations based on various data lines, so any proposed limitations can also be

accomplished by adjusting the data lines. As currently proposed, the FCC's regression model limits outputs, rather than limiting inputs and allowing the inputs to be run through the model. An excellent example of this is AL 3, also referred to as the "A" Factor, which is calculated as Cable and Wire Facilities (CWF) divided by Total CWF. The "A" Factor is used in the allocation of expenses associated with CWF. AL 3 is one of several algorithm steps that uses both AL and DL inputs to produce the result; in this case AL1, DL 255 (Account 2400 - Total CWF) and DL 815 (Account 2680 – Amortizable Tangible Assets – CWF). The FCC's proposed treatment only limits the AL1 amount, however, neither DL 255 (which includes AL1) nor DL 815 are adjusted. As a result, the algorithm is not allowed to calculate support as it was intended and produces an incorrect result.

VII. The Limitations Are Missing Critical Components

As mentioned above, accumulated depreciation and other Part 32 accounts must be taken into consideration if the FCC is going to limit the 11 proposed algorithm lines, or follow the approach to limiting the data lines described above. The FCC's proposed regression analysis does not limit the accumulated depreciation, nor does it remove amounts from other associated accounts. If the FCC is going to limit investments, the following data lines should also be analyzed:

DL 160 – Account 2001 – Total Plant in Service

DL 190 – Account 3100 – Accumulated Depreciation

DL 240 – Account 2230 – COE Transmission Equipment

DL 250 – Account 2230 – COE Category 4.13

DL 255 – Account 2410 – Total CWF

DL 270 – Account 3123 – COE Transmission Accumulated Depreciation

DL 280 – Account 3124 – CWF Accumulated Depreciation

DL 700 – Cost Study Average CWF – Total Account 2410

DL 710 – Cost Study Average CWF Cat 1 – Total Subscriber Line Plant

By not analyzing these data lines, the FCC's regression analysis yields flawed and punitive results. In addition, as discussed above, limiting the algorithm lines and not the data lines does not allow the HCLS algorithm to work as designed. There could be some question as to how to appropriately limit the accumulated depreciation reported on DL 190, DL 260, DL 270, and DL 280, but this could be handled one of two ways. First, a ratio of limited investment in the associated plant account to the total plant account could be developed and applied to the accumulated depreciation. Alternatively, the limited plant could be handled as a retirement, in which case Part 32 for retirement accounting would treat the investment as fully depreciated. Whichever method is selected would be more appropriate than the current approach of ignoring depreciation reserve and other associated accounts in the algorithm. The limitation of algorithm lines rather than data lines yields inappropriate results and ignores the net book value of the assets being removed.

VIII. The FCC's Regression Analysis Does Not Appropriately Calculate Limitations on Depreciation Expense

Depreciation expenses have not been properly accounted for in the FCC's regression model. Specifically, depreciation expenses should not be analyzed independently via regression, as they are a byproduct of the associated plant investment. Instead, depreciation expenses should be reflected as a function of the asset values removed. The FCC's current, regression-based approach results in limitations on depreciation expenses on AL 18 that are excessive and inconsistent with Part 32 accounting principles. The FCC's current approach also creates

situations where depreciation expense is limited when the associated plant account is not limited. This would suggest that the depreciation rates for these accounts are excessive, which is nearly impossible in a regulated environment. Calaveras' depreciation rates are approved by the California Public Utilities Commission and are therefore not subject to unilateral adjustment by the company. Finally, we are audited annually by an independent CPA firm that verifies the proper use of the approved depreciation rates, thus there is minimal risk of improper application. Therefore, we recommend that regression not be used to limit depreciation expense. Instead, we believe that depreciation expense limitations should be computed as the percentage of limitation of the associated plant investment multiplied by depreciation expense.

This is also critical to Calaveras. Calaveras had $103,509 of depreciation removed via the proposed regression cap on AL 18 – Depreciation and Amortization Expense assigned to COE category 4.13, which should not have been limited absent a limitation of the associated plant account. The impact of the proposed regression caps to Calaveras, just taking into consideration the $103,509 reduction of AL18 – Depreciation and Amortization Expense assigned to COE category 4.13, dropped Calaveras' HCLS from $2,220,470 to $2,142,970, a reduction of $77,500 or 3.49%.

IX. Conclusions

Calaveras Telephone Company is very concerned for the ongoing ability to meet customer demands and maintain its present level of service quality (virtually 100% reliability) in light of the significant changes outlined in proposed new FCC rules. Can the Company meet its Carrier of Last Resort obligations given the capital and operating expense limitations? These two issues provide significant ongoing concern. Is there specific incentive to continue to invest as the Company has done in the past? It is clear that the incentive to invest has been degraded

from what it was. Cash flow from operations and net income will likely be reduced, thus limiting Calaveras' ability to re-invest. Specifically, the inappropriately calculated limitations on depreciation expense cited above will directly retard cash flow. The majority of cash flow for ongoing reinvestment comes from depreciation expense. Therefore, these limitations create a ripple effect, and will likely impact the overall local economy – the ability to maintain current jobs -- and especially impact COLR and universal service obligations.

January 18, 2012

Respectfully Submitted,

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