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 CARRIERS FOR PROGRESS IN RURAL AMERICA

Introduction and Summary

Carriers for Progress in Rural America (CPRA) is a group of community-based carriers offering high speed Internet access to customers in areas where larger carriers previously declined to provide even voice service.[1] These carriers provide communication services and

[1] CPRA includes the following carriers: Bluffton Telephone Company, MGW Telephone, Inc., Piedmont Rural Telephone Cooperative, Public Service Telephone Company, Smithville Communications, Inc., Star Telephone Membership Corporation, and Valley Telephone Cooperative, Inc.

serve as economic engines in their communities both through their own operations and through their provision of broadband Internet access. As the Wireline Competition Bureau (the "Bureau") implements a framework for imposing retroactive regression-based caps on reimbursable capital expenses (capex) and operating expenses (opex) for purposes of calculating High Cost Loop Support ("HCLS"), as directed by the Commission in the *USF/ICC Transformation Order & FNPRM*,[2] the undersigned rate of return carriers urge the Bureau to: (1) minimize the uncertainty that has been injected into reimbursable capex and opex calculations; (2) ensure that the methodology used to determine the caps on reimbursable expenses adequately accounts for all important cost drivers, including (a) the rate of population growth in a study area, (b) the status of a rural carrier's network (*e.g.,* fiber versus copper), and (c) environmental, legal and regulatory costs that greatly affect construction and operating expenses and may vary significantly across study areas; and (3) not to adopt a similarly ill-advised framework with respect to Interstate Common Line Support ("ICLS"), a mechanism far different in design and purpose than HCLS.

The members of CPRA are not necessarily opposed to prospective limits on future capex or on opex, but we are deeply concerned about a framework that caps reimbursable expenses for costs already incurred or committed to based on exogenous factors that are unknown and unknowable to a carrier at the time when it has to make financial and operating

[2] *See In the Matter of Connect America Fund, A National Broadband Plan for Our Future, Establishing Just and Reasonable Rates for Local Exchange Carriers, High-Cost Universal Service Support, Developing an Unified Intercarrier Compensation Regime, Federal-State Joint Board on Universal Service, Lifeline and Link-Up, Universal Service Reform – Mobility Fund*, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 07-135, WC Docket No. 05-337, CC Docket No. 01-92, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket No. 10- 208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (Nov. 18, 2011) (*USF/ICC Transformation Order & FNPRM*).

decisions. Today, reimbursable capex and opex are based on factors that are both known to and controllable by a carrier — namely, its own capital and operating expenses. Accordingly, carriers and investors are able to anticipate and make investment decisions that make possible current technologies and state-of-art services for rural consumers based on expected HCLS payments.[3] In contrast, the framework adopted by the Commission — which will cap reimbursable expenses based on expenses incurred by other, "similarly situated" carriers — introduces levels of uncertainty and variability that will make it nearly impossible for a carrier to plan its network upgrades and expense outlays on anticipation of its expected HCLS support payments. To be sure, this uncertainty will persist every single year that the framework is in place since a carrier's peer group and the peer group's costs are both moving targets. However, during the initial year of the program, carriers will not even know how their similarly situated peers will be determined, much less the costs incurred by those carriers. Carriers will not have this information until the Bureau develops and publishes the specific methodology that will be used to determine such peer groups. There is simply no way for a carrier faced with an imminent investment decision to anticipate the level of HCLS support it can expect. The introduction of quantile regression methodology to produce caps for operating and capital expenditures adds a further level of unpredictability since it is far more complicated than other, more widely

[3] While there is some uncertainty built into the extant HCLS funding mechanism (as the Commission emphasized in its *USF/ICC Transformation Order*), the variability and uncertainty will increase substantially under the Commission's new framework for calculating HCLS support. Carriers that have a reasonable degree of confidence that they will be eligible for HCLS support are in a position to calculate and make investment decisions on the basis of their expected HCLS payments.

understood statistical techniques. The Commission's entire approach, in fact, runs counter to the statutory mandate that support be sufficient and predictable.[4]

The members of CPRA are particularly concerned about the retroactive nature of these caps, which will be applied to past investments and expense decisions. The framework adopted by the Commission requires the Bureau to publish a public notice with updated caps each year, but, as the Commission has recognized, "an individual company will not know how the cap affects its support levels until after investments are made."[5] In adopting the framework, the Commission suggested that "companies will have more certainty of support if they manage their costs to be in alignment with their similarly situated peers."[6] However, carriers will not be in a position to manage costs to align with their peers because <u>they will not know what their peers are doing until it is too late</u>. In any given year, a carrier has no way of knowing whether its costs are within the 90th (or 85th or 95th) percentile of what its peers are doing. Carriers will be asked to provide — and make the investments and expenditures necessary to provide — reliable voice and broadband services throughout their service areas without knowing the amount of HCLS support that they can expect to receive.

Where companies are reimbursed based on variable and retroactively imposed caps, they will not be in a position to make economically efficient investments necessary to support required improvements or already built network improvements and reasonable operating expenses. This will deter carriers from making investments that may be necessary to offset loop

[4] 47 U.S.C. §§ 254(b)(5), (d), and (e).

[5] *Id.* ¶ 220.

[6] *Id.* ¶ 221.

costs in high cost areas,[7] and, as importantly, investment capital will shy away from high cost areas, resulting in increased costs of capital for the carriers that need the capital the most. Even investments that would ultimately be deemed reimbursable will be chilled.

As the Bureau considers how to implement capital and operating expense constraints, the Bureau should seek to minimize the uncertainty — and the resulting chill on new investment — to the greatest extent possible. At a minimum, the Bureau should impose a transition period such that the carriers have an understanding of the specific methodology and the results that will be used to generate the capex and opex benchmarks before carriers are asked to make investment and spending decisions on the basis of the methodology. Further, the Bureau also should ensure that its analysis of which carriers are "similarly situated" adequately accounts for additional variables that cause the capital and operating expenses incurred by carriers to vary.

Finally, we urge the Bureau not to adopt a similarly ill-advised framework with respect to ICLS. Having injected substantial uncertainty into the HCLS funding mechanism, the Commission and Bureau should not similarly destabilize ICLS. These support mechanisms are substantially different, rely on different sets of data, and serve distinct purposes. The Commission would need to develop an entire new mechanism to address ICLS and cannot simply take a regression analysis built for HCLS and turn it on for ICLS support.

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[7] Such uncertainty is likely to distort investments and undermine the Commission's goal of maximizing operational efficiency. A carrier faced with a substantial, but necessary, investment in its network might avoid making such an investment and instead take an incremental approach that is *more* expensive (and thus less efficient) over the long term, but which gives it greater comfort that its capital costs will be within the 90th (or 85th or 95th) percentile. This not only undercuts the Commission's goal of maximizing operational efficiency on an individual carrier basis, but the accumulation of such investment decisions could affect the caps set by the Bureau.

I. THE REGRESSION ANALYSIS SHOULD ACCOUNT FOR ADDITIONAL VARIABLES THAT IMPACT CAPITAL AND OPERATING EXPENSES INCURRED BY CARRIERS.

The Commission expressly invited comment about the methodology that should be used in determining which companies should be deemed "similarly situated," including what variables are relevant to determining whether carriers are similarly situated with respect to capital and operating expenses.[8] To the extent the Commission relies on statistical techniques to determine which companies are similarly situated, it should not rely solely on the variables offered by the Commission: number of loops, number of housing units, and geographic measures such as land area, water area, and the number of census blocks. At a minimum, the analysis should be expanded to address such factors as the population growth rate, what level of network modernization has been completed, and the regulatory environment in a particular study area.

1. Rate of Population Growth Impacts Costs And Thus Should Be An Additional Variable Considered By The Bureau.

One critical variable that the Bureau must address relates to the rate of population growth in a study area. As population increases, new neighborhoods are built, and a telephone company must deploy new plant facilities — an investment that is at the core of the types of expenses that are reimbursable under the HCLS funding mechanism. In contrast, companies that serve longstanding population centers have lower net plant expenses and may have lower depreciation numbers. Thus, depending on recent population growth, companies will have very different debt loads, rate bases, and even operating expenses. The point is not that one company is more or less deserving of support, but rather that a closer inspection of different variables will demonstrate that companies that appear similar based on the crudest of measures — loop count

[8] *USF/ICC Transformation Order & FNPRM*, ¶ 217.

— actually could have a sound basis to have quite different profiles in terms of capital and operating expenses.

The factors that the Commission has already incorporated into the analysis fail to capture this important cost differentiator. The number of housing units in a given study area is a figure that captures population density in a static way, but it fails to capture important differences between those study areas that have recently experienced rapid growth as compared to those that have lesser population growth and thus lesser new, net plant costs. Accordingly, we urge the Bureau to use the population growth rate measured over a ten year period as an additional variable in determining whether companies are "similarly situated." Census data is one possible (public) source of this information.

2. Any Framework That Ignores The Amount of Fiber Versus Copper That Each Company Has Already Invested Is Flawed.

The Bureau also must address the varied status of network upgrades to fiber facilities if it wants to account for an important variable that affects the future investment and funding needs confronted by carriers, as well as future operating costs. For example, a carrier with only 20 percent of its network in fiber must determine a way to construct new plant to deploy broadband services and may experience higher operating costs while a company with 75 percent of its network in fiber has less of a need for investments and should have lower operating costs. Given varied levels of fiber deployment, companies that otherwise appear similarly situated may have justifiable differential costs.

3. Any Framework That Ignores The Varied Costs That May Result From Different Environmental, Legal and Regulatory Requirements Is Flawed.

We also urge the Bureau to address the varied environmental, legal and regulatory requirements which different carriers confront. For example, a carrier that must determine a way to construct new plant and deploy its services in an area with significant wetlands will incur far greater costs than an otherwise "similarly situated" carrier. In addition, some study areas may be subject to onerous restrictions on the type of construction that is permitted. Given varied regulatory sensitivities to new plant build, companies that otherwise appear similarly situated may incur justifiably differential costs.

Importantly, the geographic measures that the Commission has designated for consideration — land area, water area, and the number of census blocks — highlight topographical and geographic costs to development that will not necessarily coincide with or reflect whether a carrier is operating in an environmentally sensitive area or another area with significant legal and regulatory costs of operation. Yet these are significant costs that affect otherwise similarly situated companies unevenly and that should be accounted for in the methodology and variables developed by the Bureau, to the extent that it adopts a regression-based methodology.[9]

4. Companies Cannot Rely On The Unworkable Waiver Process For Relief.

The *USF/ICC Transformation Order & FNPRM* suggests that "[t]o the extent costs above the cap are disallowed under this new rule, companies are free to file a petition for waiver to seek additional support."[10] However, this waiver process is not workable and, in any event, is not sufficient to address a failure by the Bureau to account for key variables that cause otherwise similarly situated carriers to incur justifiably divergent levels of capital and operating expenses. *First*, the waiver standard appears to be restrictive and thus an unreliable source of

[9] We understand that it will be challenging for the Commission to account for this cost driver in a regression analysis, but that challenge reinforces the problems surrounding the use of retroactive regression-based caps to limit reimbursable capex and opex in the first instance.

[10] *Id.* at ¶ 222.

relief for carriers that incur high capital and operating costs.[11] *Second*, the volume of waivers sought would likely be too significant for the Bureau to handle in a timely way. And, *third*, we have concerns about the workability of the waiver process in the context of calculating capital and operating expense caps, including, for example, the question of whether the expenses incurred by carriers that receive waivers will be retroactively excluded from the cap calculation, which would further compound the uncertainty surrounding the framework. Because the waiver process has no shot clock, no presumption of approval, and at best a mixed record for timely consideration, the notion of a waiver is a convenient answer that offers little practical effect.

5. Especially In The Absence Of A Methodology That Accounts For All Important Cost Drivers, Companies Will Be In An Untenable Situation.

In implementing this framework and adopting the methodology used to determine peer groups, the Bureau must remain mindful of the perspective of decision makers preparing capital budgets for the following year, or even following quarter. Such decision makers will be handicapped severely in their ability to make necessary — and efficient — network investments unless they know (a) where their costs will fall in relation to their peers; (b) how this peer comparison will impact their eligibility for universal service funding; and (c) if it negatively impacts funding, whether they will receive a waiver from the Commission. The undersigned rate of return carriers are very concerned about the ability of companies to know any of these three important considerations. For the reasons described above, companies will not know where their costs will fall relative to their peers until after they have made their investment decisions. Given

[11] *See id.* at ¶ 539 (indicating that petitions for waiver will be granted only where a carrier "clearly demonstrates that good cause exists for exempting the carrier from [the capex and opex limitations], and that waiver is necessary and in the public interest to ensure that consumers in the area continue to receive voice service").

the complexity of the statistical technique, the proposed quantile regression analysis is not an accessible funding eligibility methodology for most carriers. And, even if they understand how the quantile regression will operate, carriers will not have access to the data required to populate the model. As a consequence, companies will not know whether they need a waiver, much less whether one is likely to be granted by the Commission.

II. THE COMMISSION SHOULD NOT PENALIZE COMPANIES FOR PAST INVESTMENT DECISIONS AND SHOULD REDUCE UNCERTAINTY TO THE EXTENT POSSIBLE.

There is uncertainty inherent in the Commission's framework since, for the life of the program, carriers will not know the operating expenses of their peer rate-of-return companies at the time they are making investment decisions. However, this uncertainty will be especially acute during the first years of the program: the specific methodology that will be used to generate the caps is undetermined and will not be determined until after crucial investment decisions are made. There is simply no way for carriers faced with imminent investment decisions to "manage their costs to be in alignment with their similarly situated peers," as the Commission suggests they are in a position to do.[12] Carriers do not know how their similarly situated peers will be determined, much less the costs incurred by those carriers. As a result, the framework threatens to undermine the return on investments that rate of return companies have already made or may make before July 1, 2012, when carriers will learn for the first time how they compare with similarly situated carriers. To the extent that companies are penalized for investments that they have already made, this peer-group analysis lacks basic fairness. To address this concern of retroactive penalties, we urge the Commission to direct the Bureau to impose a transition period

[12] *Id.* at ¶ 221.

(or, a "shadow year") after it establishes a specific methodology but before HCLS support is calculated on the basis of such caps.

Under the framework adopted by the Commission, on July 1, 2012 or soon thereafter, ten (or five or 15) percent of carriers will learn that they are outliers on one or more of the capital or operating expense limits. That news likely will come as a surprise to many of those carriers, since today they lack information to know how their capital and operating expenses compare with a subgroup of carriers that the Bureau has not yet identified as being similarly situated. Those carriers will be in the untenable position of already having made capital and operating expenditures in fiber, switches, and other aspects of their networks. They cannot realistically tear up that fiber or turn off their switches.

Nor will carriers have the lead time necessary to raise consumer rates to cover such expenditures, as the Commission suggested was possible in the Order, even if they wanted to.[13] Companies face significant restrictions with regard to increasing local rates. For example, many states restrict the ability of carriers to increase local rates or make state funding contingent on carriers not increasing local rates. Some carriers may have local rates that already are higher than benchmarks in the Order. Some companies operate under incentive regulation plans whereby local rates may be increased by the rate of inflation, but no more, and, in most cases, even the inflation factor is adjusted downward to account for operating efficiencies. With respect to carriers operating in other states, the Commission may have already rebalanced both state access charges and local rates and established state universal service funds, thus

[13] "[I]f the costs associated with the capital expenditures exceed their benchmarks, these carriers would have to recover those costs from sources other than USF (such as from their customer base) to ensure a return on that increased investment." *USF/ICC Transformation Order* at ¶ 219 & n. 351.

constraining local rate flexibility. If a reduction in support is immediately effective July 2012, it is extremely unlikely that any state utility commission will respond in the next several months with rate adjustments. As a consequence, many of these carriers necessarily will face a shortfall.

Absent at least a year-long transition period, the Bureau will undermine carriers' reasonable investment-backed expectations, compromising network investments over the next year and sending a chilling signal to future investors. The Bureau should address this concern by conducting the regression analysis and publishing the results in a public notice by July 1, 2012, but to provide that the change in HCLS support will not occur until July 1, 2013. The information provided to carriers in July 2012 will be extremely useful in letting carriers know where they stand, at least as of July 2012, and that will be insightful. As a result of that pubic information, some carriers may need to rethink their investment decisions or reconsider how they will earn their return. That information will induce precisely the activity the Commission is seeking to promote: critical analysis about efficient investment decisions. By contrast, using this peer-group analysis to penalize carriers for past investment decisions serves no larger public interest purpose and simply is a way to reduce expenditures.

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The framework adopted by the Commission necessarily injects variability and uncertainty into the HCLS funding mechanism to the detriment of the ability of carriers to make efficient and informed investments in their networks and operations. At a minimum, the Commission should direct the Bureau to impose a transition period or "shadow year" during which carriers will be able to make investment decisions on the basis of the specific methodology that will be used to determine such caps. Further, we urge the Bureau to ensure that the methodology used to determine capex and opex limitations considers such variables as population growth and varying legal and regulatory compliance costs.

Respectfully submitted,

/s/

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