Before the
Federal Communications Commission
Washington, D.C. 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

REPLY COMMENTS OF
TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.

I. <u>Introduction and Summary</u>

Texas Statewide Telephone Cooperative, Inc. ("TSTCI")[1] offers these reply comments on subsections A through K of Section XVII of the Commission's *Report and Order and Further Notice of Proposed Rulemaking*, FCC 11-161, released November 18, 2011 ("*Order and FNPRM*"),[2] in the above-captioned proceedings. Initial comments were filed by numerous parties on the above referenced sections of the *Order and FNPRM* on January 18, 2012. While

[1] TSTCI is an organization representing 39 small, rural incumbent local exchange companies and cooperatives in Texas, all operating under rate-of return regulation. See Attachment 1 for a list of TSTCI member companies. The members of TSTCI service over one-third of Texas's geographic area including approximately 90,000 square miles of mostly very rural, sparsely populated, and high-cost areas.

[2] *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 a Unified Intercarrier Compensation Regime; Federal-State Joint Board on Universal Service; Lifeline and Link Up; Universal Service Reform – Mobility Fund*; Report and Order and Further Notice of Proposed Rulemaking, WC Dockets No. 10-90, 07-135, 05-337, 03-109; CC Dockets No. 01-92, 96-45; GN Docket No. 09-51; WT Docket No. 10-208, released November 18, 2011.

TSTCI did not file initial comments, TSTCI generally relies on, adopts and supports the arguments and positions contained in the initial comments filed collectively by NTCA, NECA, OPASTCO, and WTA (the "Rural Associations").

These reply comments are filed in support of the Rural Associations filing and to reemphasize certain legal and policy arguments supported by TSTCI members. TSTCI limits these reply comments to two main areas. First, the FCC's regression model in Appendix H of the *Order and FNPRM* is legally and technically flawed, cannot be applied retroactively, and does not meet the requirements of universal service but is tied instead to an arbitrary budget. Next, represcription of the 11.25 percent rate of return should not be taken up until the USF and ICC reforms are in place and fully implemented and updated rules governing the represcription process are adopted.

II. <u>Regression Model is Flawed, Unlawful and Cannot Be Applied Retroactively</u>

TSTCI understands that Universal Service Reform is necessary and is not opposed to reasonable caps and changes as the Commission transitions to a broadband-based universal service methodology. However, any cap should be based in the universal service principals set out in statute. Federal law provides that support mechanisms should be specific, predictable and sufficient to preserve and advance universal service.[3] TSTCI agrees with many of those filing comments that the proposed regression model does not meet any of those standards. Instead, the proposed mechanism is being pushed to fit support within an approximate two billion dollar budget[4] without evaluation of the potential impact on universal service or if the resulting support is sufficient.

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[3] 47 U.S.C. § 254 (b)(5).
[4] *Order and FNPRM* ¶ 126.

Based on the regression analysis data released on December 2, 2011, TSTCI contends that the mechanism has a potentially negative impact on many small rural Texas ILECs.[5] This is particularly troubling when this impact comes from a model that is complex, was not available for review and comment, does not factor in important cost factors, and is applied in such an arbitrary way that it undermines the very purpose of relying upon a quantile regression analysis.

The Commission proposes a quantile regression analysis described in the *Order and FNPRM* and Appendix H which requires 11 regression studies to establish 11 caps in 11 of the cost categories that NECA uses for the HCLS calculation. Caps are then set at the 90th percentile level without any factual basis for why these categories were chosen and why the caps were set at the 90th percentile level. Independent variables are transformed using algorithms, and interdependent variables are not treated as such. TSTCI argues that this creates a very complex model that does not create results that are specific or sufficient to support universal service. Rather the model creates an arbitrary result that is in no way tied to actual costs of service but denies due process in the attempt to meet a budgeted number for the fund size. TSTCI's arguments are supported by the filed comments of several parties.[6]

TSTCI agrees with the position of the Blooston Rural Carriers and the Rural Associations that the model should have been made available for review and comment.[7] This due process violation issue is currently part of the Petition for Review[8] filed by the Rural Associations, and TSTCI will support the Rural Associations in that endeavor.

The regression analysis is also flawed in that it does not apply many important cost factors and is applied in an erroneous and arbitrary fashion. The Comments of Central Texas

[5] The preliminary data indicates that a majority of Texas RLECs, approximately 26 companies, are estimated to have a negative impact from the regression analysis.
[6] *Comments of the Nebraska Rural Independent Companies* at p.9; *Comments of Central Texas Telephone Cooperative, Inc*. at p 3. *Comments of the Rural Associations* at pp. 65-71.
[7] *Comments of the Blooston Rural Carriers* at p. 5 fn. 10; *Comments of the Rural Associations* at p. 64.
[8] Petition for Reconsideration and Clarification of NECA, OPASTCO, and WTA, WC Docket No. 10-90, *et a*l., (filed Dec. 29, 2011) at 9-12. (*Rural Association Petition for Reconsideration*).

Telephone Cooperative, Inc. (Central Texas), a TSTCI member company, present a clear example of how the regression analysis affects one rural local exchange carrier (RLEC) in Texas. Central Texas points out that excessive weight is placed on the number of loops variable in the algorithms, while length of loop and terrain factors are ignored.[9] The absence of these cost factors, among others, creates an arbitrary and confiscatory result when calculating the support for Central Texas, and TSTCI contends that it creates similarly erroneous and harmful results for many of its other members. TSTCI contends that the Commission's regression analysis will place many of the rural carriers, including members of TSTCI, in precarious financial positions and definitely does not provide the specific, predictable and sufficient support mandated by the Telecommunications Act.

In addition to the omission of important cost factors, TSTCI supports the Rural Associations general analysis of the regression model.[10] TSTCI agrees with the Rural Associations that the regression model is flawed and is being applied in an erroneous and arbitrary fashion. The Rural Associations provide an excellent analysis of the general flaws in the regression model and a specific review by the "father" of the regression analysis, Dr. Roger Koenker, that TSTCI strongly supports and reemphasizes. Dr. Koenker demonstrates that the Commission's use of quantile regression analysis is flawed and will lead to serious distortions in support if applied to HCLS or other USF calculations. There is no need to restate all the Rural Associations' findings in these reply comments; however, it is important to reiterate particular concerns with the geographical mapping data - the fundamental building block of the regression model; the arbitrary percentile threshold to determine "excessive costs," and the use (or rather misuse) of independent variables in all models.

Mapping Inaccuracies

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[9] *Comments of Central Texas Telephone Cooperative, Inc.* at pp. 4-7. This issue is also raised in the *Comments of the Blooston Rural Broadband Carriers* at p. 7; and *Comments of the Rural Associations* at pp. 65-72 and Appendix D.

[10] *Comments of the Rural Associations* at pp. 65-72 and Appendix D.

The Rural Associations describe inaccuracies in the geographical mapping data underlying the regression model, specifically the estimated study area boundaries and the mapping of census blocks to study areas. According to the Rural Associations' analysis, significant errors occurred in more than 90% of the study areas for which data was available and if extraordinary efforts are not taken to correct the inaccuracies, substantial errors will be incorporated from the start of the process.[11] Other parties expressed similar concerns. The Nebraska Rural Independent Companies (NRIC) retained a GIS consultant to evaluate these same issues, and NRIC also concluded that there are serious mapping errors and recommended the Commission not proceed with caps until these errors are resolved. To do otherwise, could result in insufficient and unpredictable support.[12] The use of a census block centroid to assign census blocks to study areas was described as a fundamental problem not only by the Rural Associations, and NRIC, but also by the Section E Rural Carriers who explain that the use of a centroid can incorrectly assign census blocks to study areas when a census block is intersected by a study area boundary.[13] Consumer Advocates also tested the use of centroids to designate a census block location within a service territory with Tele Atlas Maps (used by the Commission) and compared it with information available on the Maine GIS web site for four rate of return cost carriers. This comparison resulted in substantial differences in the total census block count for three of the four carriers, which would cause skepticism in the outcome of the regression analysis.[14] TSTCI believes that if the fundamental building block of the model has significant errors, the skepticism is not only valid, but coupled with other identified technical errors

[11] Id., at 66.
[12] *Comments of NRIC*, at p. 27.
[13] See *Comments of Clear Lake Independent Telephone Company, Ellijay Telephone Company, E. Ritter Telephone Company, Hill Country Telephone Cooperative, Inc., Lennon Telephone Company, Tri-County Telephone Company, Inc.* (Section E Rural Carriers), at p. 6.
[14] See *Comments of the National Association of State Utility Consumer Advocates, Maine Office of the Public Advocate, The New Jersey Division of Rate Counsel, and the Utility Reform Network* (Consumer Advocates), at p. 47-48.

provides good reason for the Commission to discontinue or revise the application of the regression models to limit capital and operating expenses.

Percentile Threshold to Limit Costs is Arbitrary and Will Not Pass Sufficiency Mandate

The Rural Associations contend that choosing the 90th percentile as an excessive cost threshold to limit allowable costs in an account is an arbitrary figure with no rational explanation why costs above this percentile (or any other percentile) are determined to be excessive or unnecessary. An artificial limit, such as this, will not rationally exclude excessive costs in a way that would comply with the Telecommunications Act's mandate that universal service support be sufficient.[15] Likewise, Rural Telephone Service Company (RTSC) explains how the conclusion that certain investments and expenses incurred above a 90 percentile are imprudent or inefficient cannot be justly made based on the quantile regression analysis. RTSC describes how this limitation methodology is biased against those companies who have made long term network investments in broadband-capable networks, often in compliance with lender standards. The capital and operational expenditures limitation methodology data includes the costs of companies that have not built long-term, broadband capable networks, thus lowering the average. Automatically reducing support based on the presumption that costs above a threshold are inefficient should be rejected. At the very least, the Commission should conduct further analysis as to the causes of higher costs, and the rate of return companies should not be required to go through an onerous waiver process to receive all the support calculated under the HCLS rules.[16]

Accipiter Communications, Inc. also cautions the Commission against actions whereby carriers that have made investments under the USF rules will now suffer reductions in the revenues supporting that investment because of rule changes. Such actions are "…confiscatory,

[15] Ibid., at 66.
[16] Comments of Rural Telephone Service Company, at p. 10.

antithetical to the USF goal of sustaining service for rural customers, and a precedent which left unchecked will serve to create gross unpredictability for any carrier trying to serve rural America."[17] Accipiter argues that the FCC's desired outcome may be better achieved by adjusting the cost recovery limitations to only limit costs which are an inordinate amount above the proposed 90th percentile (or other percentile) – although the model requires significant redesign before it can be adequately evaluated. Accipiter contends the Commission's main concern should be about extreme outliers, "and should consider imposing caps only upon carriers whose costs are unreasonable and are an inordinate amount above the quantile limits established under a more properly constructed model." Accipiter explains that no matter how well carriers manage their costs, there will always be a 90th percentile group of companies subject to a cap. It is arbitrary to cap all companies that may be above the 90th percentile, but not significantly astray of the remaining similarly-situated carriers.[18] TSTCI agrees that establishing a percentile threshold for limiting expenses, rather it be 90%, or some other percentage, is arbitrary and does not comply with the sufficiency mandate.

Other Flaws in the Models Produce Incorrect Estimates

Besides problems with the regression model that have been described previously in these comments, the regression analysis is technically flawed in other ways as explained in detail by the Rural Associations and other commenters referenced earlier:

Problems occur with the Commission's proposed use of quantile models to assess capital and operational expenditures in individual accounts. The same independent variables are used in all models applied to individual account data, whether or not they are statistically significant. As explained by the Rural Associations, the use of an independent variable that is not statistically significant in a model will still influence values of estimates and increase arbitrary variances in

[17] See Comments of Accipiter Communications, Inc. at p. 30.
[18] See Comments of Accipiter Communications, Inc. at 29-30.

these estimates. This weakens the power of the model to estimate accurately, a point addressed by Dr. Koenker in his analysis. Independent variables should be included in models only to the extent they are statistically significant.

However, even in the case of statistically significant variables, the Commission's models are flawed because they purport to use data that is actually unknown. This is the case with census block data that the Commission's models supposedly use for urban/rural designations. According to the Census Bureau, urban/rural data to be released from the 2010 census will only be reported at the census tract level. Therefore, the Commission's models use 2000 census data reported by census block group, which is less granular data than census block data. Of course, this data is not only out of date; it does not characterize a census block and can cause distortions regarding the urban/rural designations.[19]

There are also a number of accounting errors inherent in the models such as the presence of a model for investment with no treatment of Accumulated Depreciation reserves. This de-links the accounting for the asset from the accounting for depreciation reserves.

Finally, if a regression analysis is adopted by the FCC, it cannot be applied retroactively. The FCC clearly implies in the *Order and NFPRM* that the regression analyses will apply retroactively by capping recovery on past investment.[20] TSTCI would like to support the contention of several filed comments that jurisprudence and administrative law principles generally do not allow retroactivity in the promulgation of administrative rules and regulations.[21] Carriers have been operating and investing under a specific set of rules for decades. Applying retroactive caps to investments made under a previous structure would amount to unallowable retroactive ratemaking.

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[19] Comments of Rural Associations, Appendix D at 16-17.
[20] Order and NFPRM at ¶ 219 n. 351.
[21] See *Comments of the Blooston Rural Broadband Carriers* at pp. 3-5 and fn 8; Comments of Central Texas Telephone Cooperative, Inc. at fn. 4.

III. Rate of Return Should Remain at 11.25%

TSTCI supports the Rural Association comments on the issue of represcription.[22] TSTCI agrees that this is not the appropriate time to attempt a rate of return represcription. The current reforms are placing enough regulatory uncertainty and potential financial strain on rural carriers. Any represcription should not be taken up until after the reforms are implemented and the impacts evaluated. The process being proposed by the Commission suggests a procedural short cut to reductions in the authorized rate of return without consideration for the impact of such reductions. More appropriately, once the current regulatory reforms are implemented and the impact evaluated, a represcription process can be developed that reflects the current economic environment, marketplace changes, and regulatory impacts. At that point, the Commission would be able to present evidence and establish on the record that there is sufficient evidence to support that any rate of return below 11.25% would be just and reasonable under the Telecommunications Act.[23]

TSTCI urges the Commission to heed certain arguments on represcription made by other commenters like the National Association of State Utility Consumer Advocates[24]who recommends that the Commission "must not only look at factors that reduce the WACC, such as the reduction in interest rates and additional revenues for non-rate-of-return regulated services, but the FCC must also reflect on factors that may increase the WACC, such as the frozen separations rules and the reduction of revenue associated with the FCC universal service budget constraint for rate-of-return carriers."

In addition, TSTCI believes that the comments of Parrish, Blessing & Associates, Inc.[25] make some good arguments against the Commission's preliminary conclusion that the authorized

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[22] Comments of the Rural Associations at pp. 47-62.
[23] 47 U.S.C. § 205.
[24] National Association of State Utility Consumer Advocates, Maine Office of the Public Advocate, The New Jersey Division of Rate Counsel, and The Utility Reform Network, Comments, p. 31.
[25] Parrish, Blessing & Associates, Inc., Comments, p. 2.

rate of return should not exceed 9 percent. In particular, Parrish, Blessing argues that the Commission's analysis "ignores the ever increasing risks faced by small LECs," in the form of requirements for significant network upgrades, regulatory and revenue uncertainty and greatly reduced market share.

TSTCI agrees with these commenters that the Commission's preliminary conclusion that the authorized rate of return should not exceed 9 percent has not placed sufficient weight on the increased financial and operating risk factors facing the RLECs. TSTCI strongly supports the Rural Associations' position that represcription should not be taken up until after the reforms are implemented and the impacts evaluated.

IV. Conclusion

The Commission has established a budget capped at $2 billion annually for rate of return carriers to cover all reform changes. This is an arbitrary budget established without truly knowing the impact it will have upon these rural carriers and the rural consumers they serve. However, in order to meet this budget amount, the Commission has adopted, among other reforms, a rule to limit reimbursable capital and operations expenses for the purpose of determining HCLS support. It is proposed that limits on costs are to be determined through quantile regression methods. As demonstrated by the Rural Associations' analysis of the Commission's regression models, along with analysis by other parties, the models have significant inherent flaws that will adversely affect the support levels of many rate of return carriers without regard to whether their capital or operational expenses can truly be considered excessive. TSTCI urges the Commission to abandon the regression-based approach to limiting capital and operational expenses and adopt more reasonable methods that can be shown to meet the statutory standard that support mechanisms be specific, predictable and sufficient. In order to meet these standards, there must also be some flexibility allowed in the budget amount to accommodate reforms being implemented by the Commission.

Regarding rate of return represcription, TSTCI contends that the Commission's preliminary conclusion that the authorized rate of return should not exceed 9 percent has not taken into account the greatly increased financial and operating risk factors facing the RLEC industry.

Moreover, TSTCI urges the Commission to abandon the represcription of the 11.25 percent rate of return at this time. This is a process that should not be taken up until the USF and ICC reforms are in place and fully implemented. At that time, the impact of the reforms can be evaluated, and updated rules that reflect the current environment and current risk factors can be adopted to govern the represcription process. The Commission would then have the opportunity to present evidence to meet its burden of proof in justifying a lower rate of return under the Telecommunications Act.

Respectfully submitted,

Cammie Hughes

Cammie Hughes
Authorized Representative

Attachment 1

TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.

Alenco Communications, Inc.
Big Bend Telephone Company, Inc.
Brazoria Telephone Company
Brazos Telecommunications, Inc.
Brazos Telephone Cooperative, Inc.
Cameron Telephone Company
Cap Rock Telephone Cooperative, Inc.
Central Texas Telephone Cooperative, Inc.
Coleman County Telephone Cooperative, Inc.
Colorado Valley Telephone Cooperative, Inc.
Community Telephone Company, Inc.
Cumby Telephone Cooperative, Inc.
Dell Telephone Cooperative, Inc.
E.N.M.R. Telephone Cooperative, Inc.
Eastex Telephone Cooperative, Inc.
Electra Telephone Company
Etex Telephone Cooperative, Inc.
Five Area Telephone Cooperative, Inc.
Ganado Telephone Company, Inc.
Hill Country Telephone Cooperative, Inc.
Industry Telephone Company, Inc.
La Ward Telephone Exchange, Inc.
Lake Livingston Telephone Company
Lipan Telephone Company, Inc.
Livingston Telephone Company
Mid-Plains Rural Telephone Cooperative, Inc.
Nortex Communications, Inc.
Panhandle Telephone Cooperative, Inc.
Peoples Telephone Cooperative, Inc.
Poka Lambro Telephone Cooperative, Inc.
Riviera Telephone Company, Inc.
Santa Rosa Telephone Cooperative, Inc.
South Plains Telephone Cooperative, Inc.
Tatum Telephone Company
Taylor Telephone Cooperative, Inc.
Wes-Tex Telephone Cooperative, Inc.
West Plains Telecommunications, Inc.
West Texas Rural Tel. Cooperative, Inc.
XIT Rural Telephone Cooperative, Inc.