Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
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Rate of Return Represcription Staff Report	)	
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Connect America Fund	)	WC Docket No. 10-90
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Comments of GVNW Consulting, Inc.

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Executive Summary

While we can debate various approaches to what adequately provides a fair "hearing", it seems intuitively obvious that carriers should be allowed to present factual evidence prior to preliminary conclusions being reached. The WCB Staff Report does not address or attempt to answer the important question of what process will be used in the coming months to achieve compliance with the law found in Section 205(a). Offering comments and replies in a short time frame to the WCB Staff Report falls far short of offering the type of hearing required under the Act.

The Staff ignores and thus does not properly incorporate into its analysis one of the biggest factors that should be considered in this represcription proceeding – the Commission's own Transformation Order. While the Commission still expects carriers to meet carrier of last resort obligations and in fact increase their footprint with increased broadband capacity, it expects the carriers to do so with the reduced universal service support and phased down intercarrier compensation recovery stemming from its own November, 2011 Order. While these reductions are the subject of ongoing and yet to be resolved appellate proceedings, to simply ignore these impacts in the current docket is disingenuous.

We support the approach that was offered by the Rural Associations' (RA) in their January 2012 comments, and that we expect to see from the Rural Associations' in this current docket. This RA approach estimated a market-based cost of capital for rural LECs by dividing current free cash flow (FCF) by the value of the firm. This approach resulted in cost of capital estimates slightly above the current authorized rate.

I. INTRODUCTION AND BACKGROUND

GVNW Consulting, Inc. (GVNW) submits comments filed pursuant to the Commission's Public Notice (DA 13-1110), released on May 16, 2013. The instant Public Notice seeks comment on a Wireline Competition Bureau staff report[1] (WCB Staff Report) setting forth data and procedures the Bureau recommends the Commission use to represcribe the authorized interstate rate of return.

We note with concern that the staff has failed to recognize a realistic risk portfolio for small rural carriers. The staff report identifies a zone of reasonable estimates of the weighted average cost of capital (WACC) and concludes that the Commission should establish the revised authorized rate of return between 8.06 and 8.72 percent.

GVNW is a management consulting firm that provides a wide variety of consulting services, including regulatory and advocacy support on issues such as universal service, intercarrier compensation reform, and strategic planning for communications carriers in rural America. We are pleased to have the opportunity to offer comments addressing the issues the Bureau staff has raised in the *Public Notice*, focusing on issues for rural carriers.

[1] *Prescribing the Authorized Rate of Return: Analysis of Methods for Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 10-90, Staff Report, DA 13-1111 (Wireline Comp. Bur. rel. May 16, 2013) (Staff Report).

II. PROCEDURAL ISSUES ARE PREREQUISITE TO DOCKET CONTINUITY

The Public Notice seeks comment on some preliminary findings[2] developed by Bureau staff. In the codified Commission rules for rate of return matters, there are several important parameters that should be followed in a rate of return review. These rules were developed to enable the Commission to meet the tenets of Section 205(a) of the Act that requires such a docket to provide a full opportunity for "hearing" prior to prescribing new rates of return.

While we can debate various approaches to what adequately provides a fair "hearing", it seems intuitively obvious that carriers should be allowed to present factual evidence prior to preliminary conclusions being reached. The WCB Staff Report does not address or attempt to answer the important question of what process will be used in the coming months to achieve compliance with the law found in Section 205(a). Offering comments and replies in a short time frame to the WCB Staff Report falls far short of offering the type of hearing required under the Act.

For a represcription to yield defensible results that could withstand legal review, the rules of engagement should be determined prior to commencing the proceeding. It appears that Bureau staff is attempting to represcribe the interstate authorized rate of return without a proper[3] and necessary process. We respectfully submit that it will take keen regulatory oversight to ensure that equitable rules are offered. Diligence in this first step can provide public policy benefits in the second step.

[2] The WCB Staff Report attached to the Public Notice discusses opinions of the Bureau staff that have been developed in isolation from the normal rate of return represcription process where the affected carriers are allowed to present factual evidence.

[3] In prior represcription rounds, detailed testimony and exhibits have been submitted and carefully considered in the course of the docket.

III. THE RISK PORTFOLIO FOR RURAL CARRIERS IS NOT REFLECTED IN THE STAFF RECOMMENDATION

In the Public Notice, the Bureau asserts that it initiates this proceeding based on certain triggers have been reached. The Staff then proceeds to ignore and thus does not properly incorporate into its analysis one of the biggest factors that should be considered in this represcription proceeding – the Commission's own Transformation Order.

While the Commission still expects carriers to meet carrier of last resort obligations and in fact increase their footprint with increased broadband capacity, it expects the carriers to do so with the reduced universal service support and phased down intercarrier compensation recovery stemming from its own November, 2011 Order. While these reductions are the subject of ongoing and yet to be resolved appellate proceedings, to simply ignore these impacts in the current docket is disingenuous.

Since the last represcription, two other factors must be factored into any reasonable analysis: changes to the communications marketplace and changes to the US economy. The marketplace today looks very different from the market at the time of the last rate of return proceeding. Competition from wireless providers, cable companies, and VoIP providers has proliferated and shows no sign of slowing anytime soon. In the Commission's Public Notice (DA 13-1112), released on May 16, 2013, some recognition of this is in the record with that proceeding to evaluate options to provide universal service support in situations that customers do not purchase local wireline service. A corollary recognition of this factor is appropriate in the instant proceeding. With regard to the national macroeconomic situation, the current interest rates are historically low due to the unprecedented intervention of the Federal Reserve Board. No evidence exists to suggest the current low interest rates will hold for a long period of time.

IV. ADDITIONAL CONSIDERATION SHOULD BE GIVEN TO THE DCF METHODOLOGY

Historically, previous Commission's have declined to rely on the Capital Asset Pricing Model (CAPM) in rate of return dockets. In the most recent rate of return setting exercise in 1990, there was no reliance on any CAPM results in determining the 11.25 percent rate of return that has been in place for over two decades.

Even the current WCB Staff Report recognizes one of the key flaws in the CAPM methodology with the statement at paragraph 58 that key components "*are prone to measurement error because these estimates involve speculation as to investor expectations*. (*Footnote omitted*)" The WCB Staff Report also acknowledges that CAPM inputs are difficult to measure precisely.

As an alternative to the problems inherent in the CAPM approach, we support the approach that was offered by the Rural Associations' (RA) in their January 2012 comments, and that we expect to see from the Rural Associations' in this current docket. This RA approach estimated a market-based cost of capital for rural LECs by dividing current free cash flow (FCF) by the value of the firm. For the 2012 filing, the RA developed firm valuation data by reviewing the per-line prices paid in a sample of rural LEC acquisition transactions. This approach resulted in cost of capital estimates slightly above the current authorized rate of 11.25 percent.

Various forms of Discounted Cash Flow (DCF) models used in cost of equity capital analysis for regulatory proceedings represent a marriage of common sense and financial theory. The model attempts to answer the seminal investment question: "How much is this stock worth?" The common sense portion of the answer stems from the fact that the answer depends on what the investor expects to get out of the stock and over what period of time they expect to receive it. The "what" portion is the expected cash flow stream that will be generated by the stock and the "what period" aspect is the projected timing of the expected cash flow stream.

We respectfully submit that the Commission would be well served to interject some common sense into this docket as it seeks to represcribe an interstate rate of return that will have a large impact on the deployment and sustainability of broadband infrastructure in the large portion of the land area served by rural carriers in this country. For a broadband plan to actually be considered a National Broadband Plan, the public policies adopted to implement the plan must meet the needs of both urban and rural consumers. A revised interstate rate of return set at the level recommended in the WCB Staff Report does not meet such a test for rural customers.

Respectfully submitted,

Via ECFS at 7/24/13

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