Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 200554

In the Matter of	)	WC Docket No. 09-51
	)	CC Docket Nos. 01-92, 96-45
Connect America Fund	)	WC Docket Nos. 10-90, 07-135, 05-337,
	)	03-109
	)	WT Docket No. 10-208

REPLY COMMENTS
of the

ALASKA TELEPHONE ASSOCIATION
CALIFORNIA COMMUNICATIONS ASSOCIATION
COLORADO TELECOMMUNICATIONS ASSOCIATION
ILLINOIS INDEPENDENT TELEPHONE ASSOCIATION
INDIANA EXCHANGE CARRIER ASSOCIATION
IDAHO TELECOM ALLIANCE
IOWA TELECOMMUNICATIONS ASSOCIATION
RURAL IOWA INDEPENDENT TELEPHONE ASSOCIATION
LOUISIANA TELECOMMUNICATIONS ASSOCIATION
TELECOMMUNICATIONS ASSOCIATION OF MAINE
MINNESOTA TELECOM ALLIANCE
MISSOURI SMALL TELEPHONE COMPANY GROUP
MONTANA INDEPENDENT TELECOMMUNICATIONS SYSTEMS
MONTANA TELECOMMUNICATIONS ASSOCIATION
NEVADA TELECOMMUNICATIONS ASSOCIATION[1]
TELEPHONE ASSOCIATION OF NEW ENGLAND
NEW HAMPSHIRE TELEPHONE ASSOCIATION
OKLAHOMA TELEPHONE ASSOCIATION
SOUTH DAKOTA TELECOMMUNICATIONS ASSOCIATION
TENNESSEE TELECOMMUNICATIONS ASSOCIATION
TEXAS STATEWIDE TELEPHONE COOPERATIVE, Inc.
TELEPHONE ASSOCIATION OF VERMONT
WASHINGTON INDEPENDENT TELECOMMUNICATIONS ASSOCIATION
WISCONSIN STATE TELECOMMUNICATIONS ASSOCIATION
WYOMING TELECOM ASSOCIATION

August 26, 2013

[1] The positions expressed in these reply comments do not reflect the positions of AT&T.

TABLE OF CONTENTS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 200554

In the Matter of	)	WC Docket No. 09-51
	)	CC Docket Nos. 01-92, 96-45
Connect America Fund	)	WC Docket Nos. 10-90, 07-135, 05-337,
	)	03-109
	)	WT Docket No. 10-208

REPLY COMMENTS

I. INTRODUCTION AND SUMMARY

The Alaska Telephone Association, California Communications Association, Colorado Telecommunications Association, Illinois Independent Telephone Association, Indiana Exchange Carrier Association, Idaho Telecom Alliance, Iowa Telecommunications Association, Rural Iowa Independent Telephone Association, Louisiana Telecommunications Association, Telecommunications Association of Maine, Minnesota Telecom Alliance, Missouri Small Telephone Company Group, Montana Independent Telecommunications Systems, Montana Telecommunications Association, Nevada Telecommunications Association[1], Telephone Association of New England, New Hampshire Telephone Association, Oklahoma Telephone Association, South Dakota Telecommunications Association, Tennessee Telecommunications Association, Texas Statewide Telephone Cooperative, Inc., Telephone Association of Vermont, Washington Independent Telecommunications Association, Wisconsin State Telecommunications Association, and Wyoming Telecom Association (collectively, the State Associations) hereby file these reply comments in the above-captioned proceedings. By Public

[1] The positions expressed in these reply comments do not reflect the positions of AT&T.

Notice released May 16, 2013,[2] the Wireline Competition Bureau has requested comment on a report prepared by Bureau staff regarding potential data and methods to be used in represcribing the authorized interstate rate of return (RoR) for rate-of-return regulated rural local exchange carriers (RLECs). Utilizing the methodology described in the report, the staff has recommended that the authorized interstate RoR be reduced from its current 11.25% level to a range between 8.06% and 8.72%.[3]

Each of the State Associations has RLEC members that serve rural consumers living in some of the highest-cost-to-serve areas of our nation. As described more fully below, if the authorized RoR were reduced to the levels recommended in the Staff Report, in addition to other burdensome changes that have been implemented recently in response to the USF/ICC Transformation Order,[4] the ability of RLECs to deliver broadband services to these consumers will be seriously harmed, and the Commission's goal of delivering high-quality, affordable broadband services to all Americans will be even more gravely threatened.

On July 25, 2013, fourteen parties filed comments in response to the Public Notice.[5] Of these commenters, only two parties supported the RoR reductions proposed in the Staff Report. Significantly, neither of these parties provided any facts or data supporting the accuracy or

---

[2] Wireline Competition Bureau Seeks Comment on Rate of Return Represcription Staff Report, WC Docket No. 10-90, *et al*. Public Notice DA 13-1110.

[3] Wireline Competition Bureau, *Prescribing the Authorized Rate of Return: Analysis of methods for establishing Just and Reasonable Rates for Local Exchange Carriers,* Staff Report (released May 16, 2012).

[4] Report and Order and Further Notice of Proposed Rulemaking, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92 and 96-45, and WT Docket No. 10-208, Released November 18, 2011, FCC 11-161.

[5] Parties filing comments include Alaska Rural Coalition (Alaska), Alexicon, Rural Broadband Alliance, Small Company Coalition and Alexicon Companies (Alexicon *et al*), Eastern Rural Telecom Association (ERTA), GVNW Consulting, Inc. (GVNW), ICORE Companies (ICORE), John Staurulakis, Inc. (JSI), Moss Adams Companies (Moss Adams), National Association of State Utility Consumer Advocates (NASUCA), National Congress of American Indians (NCAI), National Cable and Telecommunications Association (NCTA), National Exchange Carrier Association, NTCA – The Rural Broadband Association, USTelecom, Eastern Rural Telecom Association and Western Telecommunications Alliance (Rural Associations), National Tribal Telecommunications Association (NTTA), Oregon Telecommunications Association and Washington Independent Telecommunications Association (OTA & WITA), Rural Telephone Finance Cooperative (RTFC).

reasonableness of the staff's recommendations or the methodology used to develop the proposed RoR range. In contrast, the other twelve commenting parties provided significant analysis and evidence of errors and inaccuracies in the Staff Report methodology. Indeed, the record shows that when appropriate corrections are made to the staff methodology the necessary RoR may actually be *higher* than the current 11.25% prescribed level.

The State Associations therefore respectfully recommend that the Commission disregard the Staff Report in light of such shortcomings and instead maintain at least the current prescribed level given the market realities that small RLECs face.

II. DISCUSSION

A. The comments contain little or no evidence supporting the accuracy or reasonableness of the methodology and data utilized in the Staff Report

It is notable that only two parties (NCTA and NASUCA) filed comments in support of represcribing the authorized RoR to the levels recommended in the Staff Report. Together these filings total only 10 pages and contain no facts or data supporting the validity or applicability of the methodology used for determining the appropriate return level for rural RoR carriers, or the data used in this process. Significantly, neither of these filings addresses the effect that reducing the authorized RoR to the levels recommended in the Staff Report will have on the Commission's ultimate goal of delivering broadband service to consumers throughout rural America. Such bald, results-oriented pleadings provide no basis for action to represcribe the RoR.

B. The comments highlight significant shortcomings in the methodology utilized in the Staff Report

i. The proxy group chosen for the WACC analysis does not accurately reflect the risks and capital market realities faced by small rural RoR carriers

Perhaps the best description of the flaws in the staff analysis can be found in the statement of Prof. Randall S. Billingsley included as Appendix A to the Rural Associations' comments. Among the concerns addressed in Prof. Billingsley's statement are:

- The Staff Report's sample is unrepresentative of the average RLEC;
- Failure to consider the effects of small firm size and illiquidity on capital costs;
- The Staff Report uses an artificially low risk-free RoR in applying the CAPM model;
- The Staff Report arbitrarily and selectively limits chosen input values and contradicts the well-accepted risk/return trade-off principles; and
- The Staff Report's cost of capital results defy common sense.

Further confirmation of the problems with the staff analysis is summarized in the comments of the Rural Telephone Finance Cooperative – a major source of capital for the RLEC industry:

> The Wireline Competition Bureau should search for methods of estimating RLECs' cost of capital that do not rely on publicly traded proxy companies because the return and risk profile of these companies bear little resemblance to the financial, business, and regulatory challenges facing non-publicly traded RLECs.[6]

The Rural Associations propose a reasonable alternative for developing the cost of capital (assuming first that proper procedures are followed) using RLEC-specific data rather than data assembled from proxy companies. As described beginning on page 31 of the Rural Associations' comments, and further delineated in Appendix B to the comments, this approach estimates a market-based cost of capital for RLECs by dividing current free cash flow (FCF) by

[6] RTFC at p2. See also Alaska at p9, Alexicon *et al* at p2, GVNW at p6, ICORE at p7, JSI at p3, NCAI at p1, Rural Associations at p21, NTTA at p5, and OTA &WITA at p2.

the value of the firm. The State Associations believe that this approach, or another approach based in a more targeted manner on RLEC-specific data, would yield a more reasonable and accurate RoR result that reflects market realities and would have a better chance of achieving the Commission's stated goals for rural broadband investment and broadband availability to rural consumers.

ii. The analysis fails to recognize the impact of the revenue and high-cost support reductions contained in the FCC's USF/ICC Transformation Order

As stated by ERTA, "The Commission took several independent steps in its USF/ICC [Transformation] Order that collectively have resulted in large revenue losses and uncertainty for RLECs."[7] In its comments JSI states, "Add to this the uncertainty about the authorized RoR, and the investment behavior of the RLEC industry suffers greatly, as noted by FCC Commissioner Ajit Pai in his statement on the Sixth Order on Reconsideration [of the USF/ICC Transformation Order]."[8] The cumulative effect of these regulatory overhangs is to increase the regulatory risk faced by RLECs, which has the effect of increasing the cost and reducing the availability of capital, which makes it more difficult for RLECs to make needed broadband infrastructure investments.

iii. When appropriate adjustments are made to account for the risk and capital market realities of rural RoR carriers, the necessary RoR appears to be *higher* than the currently authorized 11.25%

Utilizing the Free Cash Flow methodology and excluding the lowest per-line prices paid in recent sales of rural telephone companies, the Rural Associations found median cost of capital

[7] ERTA at p6.
[8] JSI at p4. See also Alaska at p7, GVNW at p6, ICORE at p2, Moss Adams at p8, NTTA at p2, OTA & WITA at p2, Rural Associations at p21, RTFC at p7..

values ranging from 11.75% and higher, depending on the per-line values.[9] Utilizing a modified CAPM model with adjustments for size and company-specific risks, Alexicon *et al* determines that a reasonable RoR range for RLECs should be 13.75% to 16.36%.[10] Using a similar approach, NTTA develops a RoR for Tribally-owned carriers of 16.08%.[11] These specific, evidentiary-based assessments stand in stark contrast to the lonely, cursory pleadings urging the Commission to take some – any – steps to reduce the RoR without analysis of level or impact.

C. Many parties comment on the adverse impact of the proposed RoR reductions on the Commission's goals for broadband deployment

The downside risks of an unwarranted and untimely reduction in RLEC RoR, on top of the already significant reductions in high-cost support and intercarrier compensation that are being implemented, are perhaps best summarized in this statement by Moss Adams:

> Any significant reduction in the authorized RoR is likely to have a direct impact on these carriers' access to capital and their resulting ability to invest in the provision of universal service to the most remote and high cost areas of the country, where there is no waiting list of carriers to take their place.[12]

---

[9] Rural Associations at p32. This analysis included rural company sales between 2008 and 2011, and per-line prices of from $2,400 to $1,200. There has been a steady decline in valuations over this time period, with some recent sale transactions priced at only $600 per-line. Lower prices will result in higher cost of capital estimates. It is likely that these lower per-line values are due, at least in part, to the regulatory uncertainty created by the high-cost support and intercarrier compensation reductions in Transformation Order and the threat of more changes to come via the 2011 Further Notice of Proposed Rulemaking, including a potential reduction in authorized RoR as contemplated here. See also GVNW at p7.

[10] Alexicon *et al* at p31.

[11] NTTA at p11-12.

[12] Moss Adams at p27. See also Alaska at p7, ERTA at p12, GVNW at p 8, ICORE at p5, JSI at p5, NCAI at p2, NTTA at p4, OTA & WITA at p5, RTFC at p7, Rural Associations at p19.

III. CONCLUSION

For the reasons stated above, the Commission should decline to proceed further with represcription – although should this process continue, it must follow proper procedures – and as discussed herein, all available data and thoughtful analysis show that the Staff Report does not provide a reasonable or adequate basis to justify reducing the authorized RoR.

Respectfully submitted,

ALASKA TELEPHONE ASSOCIATION
/s/ James Rowe
James Rowe
Executive Director
201 E. 56th Avenue, Suite 114
Anchorage, AK 99518
907-563-4000

CALIFORNIA COMMUNICATIONS ASSOCIATION
/s/ Eric G. Wolfe
Eric G. Wolfe
Board of Directors Chairman, and CEO
PO Box 42230
Bakersfield, CA 94484-2230
661-834-7770

COLORADO TELECOMMUNICATIONS ASSOCIATION
/s/ Pete Kirchhof
Pete Kirchhof
Executive Vice President
225 E. 16th Avenue, Suite 260
Denver, CO 80203
303-795-8080

ILLINOIS INDEPENDENT TELEPHONE ASSOCIATION
/s/ Lee H. Witcher
Lee H. Witcher
Chairman
213 S. Main Street, PO Box 149
Waterloo, IL 62298
618-939-9252

INDIANA EXCHANGE CARRIER ASSOCIATION
/s/ Bruce A. Hazelett
Bruce A. Hazelett
President
12069 Bayhill Drive
Carmel, IN 46033
317-913-7934

IDAHO TELECOM ALLIANCE
/s/ Kate Creswell
Kate Creswell
Executive Director
PO Box 1638
Boise, ID 83701
208-229-1482

IOWA TELECOMMUNICATIONS ASSOCIATION
/s/ Dave Duncan
Dave Duncan
President
2987 100th Street
Urbandale, IA 50322
www.Broadband4Iowa.com

RURAL IOWA INDEPENDENT TELEPHONE ASSOCIATION
/s/ Sheila Navis
Sheila Navis
Executive Director
100 Court Avenue, Suite 218
Des Moines, IA 50309
515-243-1743

LOUISIANA TELECOMMUNICATIONS ASSOCIATION
/s/ Larry G. Henning
Larry G. Henning
President
7266 Tom Drive, Suite 205
Baton Rouge, LA 70806
225-927-1377

TELECOMMUNICATIONS ASSOCIATION OF MAINE
/s/ Thomas Murray
Thomas Murray
President
56 Campus Drive
New Gloucester, ME 04260
207-688-8488

MINNESOTA TELECOM ALLIANCE
/s/ Brent J. Christensen
Brent J. Christensen
President/CEO
1000 Westgate Drive, Suite 252
St. Paul, MN 55114
651-291-7311

MISSOURI SMALL TELEPHONE COMPANY GROUP
/s/ W.R. England III and *Brian T. McCartney*
W.R. England III and Brian T. McCartney
Attorneys for the Missouri STCG
312 Capitol Avenue
Jefferson City, MO 65102-0456
573-635-7166

MONTANA INDEPENDENT TELECOMMUNICATIONS SYSTEMS
/s/ Bonnie Lorang
Bonnie Lorang
General Manager
2021 Eleventh Avenue
Helena, MT 59601
406-594-9662

MONTANA TELECOMMUNICATIONS ASSOCIATION
/s/ Geoff Feiss
General Manager
208 N. Montana Avenue, Suite 105
Helena, MT 59601
406-442-4316
gfeiss@telecomassn.org

NEVADA TELECOMMUNICATIONS ASSOCIATION[14]
/s/ Mike Eifert
Mike Eifert
Executive Director
PO Box 34449
Reno, NV 89533-4449
775-827-0191

[14] The positions expressed in these reply comments do not reflect the positions of AT&T.

TELEPHONE ASSOCIATION OF NEW ENGLAND
/s/ Marc Violette
Marc Violette
Executive Vice President
39 West Main Street
Warner, NH 03278
603-456-3300

NEW HAMPSHIRE TELEPHONE ASSOCIATION
/s/ Ryan Taylor
Ryan Taylor
President
PO Box 87
Weare, NH 03281
603-529-9911

OKLAHOMA TELEPHONE ASSOCIATION
/s/ Mark M. Gailey
Mark M. Gailey
Vice President
3800 N. Classen, Suite 215
Oklahoma City, OK 73118
405-525-7700

SOUTH DAKOTA TELECOMMUNICATIONS ASSOCIATION
/s/ Richard D. Coit
Richard D. Coit
Executive Director
320 E. Capitol Avenue
Pierre, SD 57501
605-224-7629

TENNESSEE TELECOMMUNICATIONS ASSOCIATION
/s/ Levoy Knowles
Levoy Knowles
Executive Director
PO Box 7531
McMinnville, TN 37111
931-235-2987

TEXAS STATEWIDE TELEPHONE COOPERATIVE INC
/s/ Weldon R. Gray
Weldon R. Gray, CPA
Chief Executive Officer
316 W. 12th Street, Suite 102
Austin, TX 78701
903-658-0055

TELEPHONE ASSOCIATION OF VERMONT
/s/ Kimberly Gates
Kimberly Gates
President
P.O. Box 96
Franklin, VT 05457
802-285-9911

WASHINGTON INDEPENDENT TELECOMMUNICATIONS ASSOCIATION
/s/ Betty Buckley
Betty Buckley
Executive Director
2405 Evergreen Park Drive SW #B4
Olympia, WA 98507
360-352-5453

WISCONSIN STATE
TELECOMMUNICATIONS
ASSOCIATION
/s/ Bill Esbeck
Bill Esbeck
Executive Director
122 W. Washington Avenue, Suite 1050
Madison, WI 53703
608-256-8866

WYOMING TELECOM
ASSOCIATION
/s/ Kelly Hoffman
Kelly Hoffman
President – WYTA
PO Box 70
Cokeville, WY 83114
307-279-3241