Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
Universal Service Reform	)	WT Docket No. 10-208
	)	
ETC Annual Reports and Certifications	)	WC Docket No. 14-58
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	))	WC Docket No. 07-135
	)	
Developing an Unified Intercarrier Compensation Regime	))	CC Docket No. 01-92

COMMENTS OF THE SMALL COMPANY COALITION

The Small Company Coalition (SCC), a national group of rural telecommunications and broadband providers, hereby offers these comments in response to the Federal Communications Commission's (FCC) Further Notice of Proposed Rulemaking (FNPRM) in which it proposed certain near term and longer term reforms to the rate-of-return (RoR) carrier federal universal service support mechanisms.[1] All SCC member companies[2] are rate-of-return (RoR) regulated rural local exchange carriers and are thus, in one way or another, directly affected by any decisions made in this proceeding.

I. INTRODUCTION

The Commission proposes a number of reforms to RoR carrier support mechanisms, both near term and longer term. The SCC will provide comment on three aspects of the FNPRM - (1) revision of the mechanism to distribute high cost loop support (HCLS) affected by the overall cap, (2) the standalone broadband funding mechanism, and (3) the voluntary election of incentive regulation and/or Connect America Fund (CAF) Phase II support by RoR carriers.

[1] *Further Notice of Proposed Rulemaking,* WC Docket No. 10-90, et al., released June 10, 2014
[2] A list of SCC's members is contained in Appendix 1

These comments will be provided through the continued advocacy of the SCC's Universal Service Fund Broadband (USFB) proposal.[3]

The SCC supports the Commission's efforts to identify and adopt a long-term broadband-focused CAF for use in areas served by RoR carriers. However, the apparent direction taken by the Commission in the FNPRM favors use of a forward looking cost model - a way to estimate the costs of telecommunications networks without reference to the actual costs incurred by the carrier. The Commission further proposes to use the current cost model - the Connect America Cost Model (CACM) - for RoR areas on a voluntary basis, either directly or via a voluntary conversion of RoR carriers to price cap regulation. The SCC continues to advocate for a funding mechanism based on the proven embedded, or actual, cost methodology. As will be explained in detail below, the SCC's USFB proposal addresses all the near term and longer-term reform goals expressed by the Commission in the FNPRM, and meets all statutory universal service mandates.

II. THE UNIVERSAL SERVICE FUND BROADBAND PROPOSAL MEETS THE COMMISSION'S NEAR TERM AND LONGER TERM REFORM GOALS

The Commission hopes to, in its near term reforms to the RoR carrier support mechanisms, find "the best way to encourage continued investment in broadband networks throughout rural America to ensure that all consumers have access to reasonably comparable services at reasonably comparable rates."[4] Specifically, the Commission looks to, in the near term, address "significant concerns regarding the structure and incentives created under the existing high-cost mechanisms for rate-of-return carriers, such as the 'race to the top' incentives that exist under the HCLS and the 'cliff effect' of the annual adjustment of the HCLS cap."[5] The SCC agrees with the Commission's goal to encourage continued investment in broadband networks, especially in those areas that are hardest to reach. However, as to "race to the top", SCC states that one party's "race" is another party's cost recovery for prudently incurred investments.

[3] For the latest versions of this proposal, see July 29, 2014 and June 22, 2014 SCC Ex Parte filings in WC Docket No. 10-90 (*SCC Ex Parte*)
[4] *FNPRM* at 258
[5] *Id.*, at 259

A. The SCC's USFB Proposal Goals Are Consistent With the Commission's Goals

In the *Transformation Order*[6], the Commission adopted several goals for its universal service fund programs, including (1) modernize the USF to include broadband capable networks and services, (2) establish further fiscal responsibility and create efficiency in the programs to control the size of the fund, (3) implement further accountability measures, and (4) adopt proper incentives to invest in broadband technologies. The SCC's USFB proposal's goal is to create an explicit, efficient and fair funding mechanism that incents the deployment of broadband networks and the transition to IP (Internet Protocol) networks. The USFB proposal accomplishes this by providing carriers with revenues that are sufficient to enable recovery of capital and operating costs, including a reasonable return on investment, incurred to provide universal broadband services to rural consumers at rates and conditions comparable to those charged to consumers in urban areas.

The above listed goals are substantially consistent, with the emphasis being on the best way to ensure broadband investment continues in rural areas and broadband services are available to as many customers in these areas as possible. In addition, the SCC's proposal meets and/or exceeds Section 254 principles: (1) quality services should be available at just, reasonable, and affordable rates, (2) all regions of the nation should have access to advanced telecommunications and information services, (3) consumers should have access to telecommunications services that are reasonably comparable to those offered in urban areas at rates that are reasonably comparable to the rates charged in urban areas, and (4) support mechanisms should be specific, predictable, and sufficient to preserve and advance universal service.

The SCC's USFB proposal would modernize the federal support mechanisms by overhauling existing embedded cost-based programs to better recognize the need to support broadband infrastructure. It accomplishes this by utilizing current FCC rules contained in Part 36, and adjusting these rules so as to separately and specifically identify equipment used to provide broadband service, for eventual inclusion in a broadband high cost loop fund (BHCLF). These costs exist today, but are treated, under current FCC rules, as interstate special access

[6] *In the Matter of Connect America Fund*, Report and Order and Further Notice of Proposed Rulemaking, WC Docket No. 10-90, et. al., released November 18, 2011 (FCC 11-161) (*Transformation Order*)

services. By separately identifying these costs, the SCC's USFB would allow the Commission and participating carriers better visibility into what it takes, in terms of actual costs incurred by the RoR carrier.

B. The SCC USFB Proposal Solves the "Cliff Effect" of the Annual Adjustment of the HCLS Cap

The Commission expresses concern over, and proposes a solution to, the annual adjustment of the HCLS fund to recognize the overall cap on the fund.[7] The SCC USFB proposal solves this problem by revamping the current mechanisms and changing how support is distributed. Under the Commission's proposal, there would still be companies affected more than others - instead of the "cliff effect", the Commission's proposal would affect the relatively higher cost carriers more than the lower cost carriers. While the Commission's proposal would, in theory, eliminate the cliff effect, the SCC's proposal would eliminate the circumstances that lead to the cliff effect and the Commission's less-than-optimal solution as set out in the *FNPRM*.

C. The SCC USFB Proposal Provides for Standalone Broadband Service Support

The SCC USFB proposal recognizes the need to support standalone broadband services, an issue addressed in the FNPRM as a near term reform.[8] As it now stands, companies providing standalone broadband services (such as data only digital subscriber line service), experience a decrease in HCLS support due to the way the HCLS calculation works. The Commission seeks comment on a standalone broadband funding proposal that (a) calculates support amounts that remain within the existing RoR budget, (b) distributes support equitably and efficiently, so that all RoR carrier have the opportunity to extend broadband service where it is cost-effective to do so, (c) distributes support based on forward-looking costs (rather than embedded costs), and (d) ensures that no double recovery occurs by removing the costs associated with the provision of broadband Internet access service from the regulated rate base.[9]

SCC's USFB proposal in large part meets the above criteria. While the Commission proposes that the standalone broadband funding mechanism be based on forward-looking costs,

[7] *FNPRM* at 259-262
[8] *Id*., at 269-275
[9] *Id*., at 269

the SCC disagrees that this is the best approach, especially when considering the fact that the lack of standalone broadband funding is causing real problems today. SCC states that, even if forward-looking costs are decided as the best way to determine overall RoR carrier support, it does not have the necessary track record to apply as a fix to the very real and immediate problem of funding standalone broadband services. SCC's proposal identifies broadband network investment, currently being allocated to interstate special access service, and places it in the calculation of the BHCLF. In this way, all broadband equipment can be separately identified and supported, via a federal mechanism, to the extent necessary, while at the same time being based on a costing methodology, embedded costs, that has proven to be successful in preserving and enhancing universal service in high cost rural areas for decades.

D. The SCC's Proposal Provides a Long Term Solution for Universal Broadband Service

A key part of the SCC's USFB proposal is its proposal to provide a long term, broadband-focused, Connect America Fund for areas served by RoR carriers. The USFB accomplishes this by reforming the current HCLS and interstate common line support (ICLS) mechanisms and presenting a comprehensive solution that supports the deployment of broadband services as well as maintaining support for current voice telephony services.

The USFB provides for a Broadband High Cost Loop Fund (BHCLF) where RoR carrier support is based on actual costs and calculated through a modified high cost loop model designed to incorporate broadband costs. SCC's proposal also replaces and combines the current HCLS and ICLS mechanisms, and provides a predictable and sufficient method for recovery of legacy investment, support for ongoing operating costs, and funding for new broadband investment.

Next, under the SCC's proposal, is the concept of the rate-of-return average cost per loop (RACPL). The RACPL will allow the Commission to analyze, on a state-by-state basis, the statistical outliers (in terms of RACPL). This statistical analysis can then be used to trigger a possible additional level of review, oversight, and inquiry. The trigger can be used to help curtail fraud, waste, and abuse, while requiring companies to adhere to reasonable spending limits.

Finally, the SCC recognizes that interstate broadband equipment included in 47 CFR § 36 (Part 36) categories is currently recovered through interstate special access charges. The BHCLF algorithm would allow the identification and quantification of support attributed to broadband investment categories by adjusting broadband investment out of the special access category into the BHCLF. The key point is that the BHCLF provides for a long term solution to ensuring broadband investment flourishes in rural areas served by RoR carriers. It accomplishes this not, as seems to be the overriding presumption by the Commission, by bringing in an entirely new mechanism based on an unproven forward looking cost model, but by utilizing a revised embedded cost methodology that has proven, time and again, to ensure rural high cost areas served by RoR regulated ILECs have access to quality, affordable voice and broadband services.

III. THE SCC'S UNIVERSAL BROADBAND SERVICE PROPOSAL IS THE BEST WAY FORWARD

RoR carriers need a stable, predictable, and sufficient universal service mechanism in order to continue investing and providing service in rural high cost areas. Adopting, at this point, a forward-looking cost mechanism for standalone broadband funding, or for the long term broadband-focused CAF, is to invite further instability for rural, RoR carriers. The SCC's USFB proposal avoids this problem by revising, and not scrapping, the embedded cost-based system - a system that has proven to work for rural RoR carriers.

A. The USFB Contains a Mechanism to Promote Efficiency

One of the Commission's main goals in reforming the legacy high cost support mechanisms for RoR carriers is to encourage fiscal responsibility and efficiency.[10] In recognition of this goal, the SCC proposes a capping mechanism that would accomplish this goal. Specifically, the USFB' capping mechanism adopts criteria for use in defining "high cost" that takes into consideration three factors: (1) number of combined access lines and broadband connections per square mile, (2) extreme weather conditions, and (3) percent of IP versus non-IP plant in a given network. The SCC believes these factors, when considered in combination, present a more appropriate way to distinguish varying levels of "high cost-ness" as exhibited in

[10] *Transformation Order* at 11

RoR RLEC areas than, for example, the Commission's recently eliminated HCLS benchmarking mechanism.[11]

It must be emphasized that this capping mechanism should not be utilized as a way to automatically reduce recipient support. Instead, this mechanism should only be used to identify possible areas for further review, the targets of which should have a full opportunity to respond to the Commission's review prior to any support revision determinations are made.

B. The Benefits of the SCC's Universal Broadband Service Proposal

There are substantial benefits to adopting the SCC's USFB proposal, especially when considering the alternatives offered in the FNPRM. First and foremost, the USFB is based on tried and true embedded cost methodologies. As compared to a forward-looking cost methodology, embedded cost methodologies, such as the HCLS, have a long track record of successfully implementing the United States' universal service policies. The same cannot be said of forward-looking costs when it comes to universal service in areas served by RoR ILECs.[12] The USFB also works within the $2 billion budget established by the Commission for the overall RoR support mechanisms and can be modified to accommodate a larger or smaller fund size. In addition, predictable and sufficient funding is generated by retaining, during a transition period, the existing HCLS algorithm. Once the USFB' proposed long term CAF for RoR carriers is implemented, RoR carriers will be better incented to invest in the long term broadband future of the areas and customers they serve - a result that is in everyone's interest.

C. Concerns with a Forward-Looking Cost Mechanism

The Commission, directly, in the case of a standalone broadband funding mechanism, and implicitly, in the case of a long-term broadband CAF, favors using a forward-looking cost methodology for determining RoR carrier support. The SCC USFB proposal, on the other hand, utilizes an embedded cost-based methodology similar to what is in use today. It is SCC's opinion that a forward-looking cost methodology should not be adopted at this time for determining RoR carrier support of any kind.

[11] *In the Matter of Connect America Fund*, Seventh Order on Reconsideration (FCC 14-54), WC Docket No. 10-90, et al., at 127-137
[12] Forward-looking cost methodologies will be discussed further below.

While price cap carriers have been receiving support based on a forward-looking cost model for over 10 years, and are now close to being subject to the support generated by the CACM, the same cannot be said for RoR carriers. Thus, forward-looking cost models do not have a sufficient record for supporting voice or broadband services in the high-cost rural areas served by RoR carriers. Unless a forward-looking cost model, such as the CACM, is properly analyzed, vetted, and revised to demonstrably work in high cost rural areas served by RoR carriers, the Commission should not propose adoption of such a model for RoR carriers.

The problems with forward-looking cost models being used for RoR carriers have been documented well, with the most comprehensive review being done by the Rural Task Force (RTF), established to assist the Commission in 1999-2000 with determining the best approach to take for RoR carriers (at that time, rural carriers). The RTF rejected the use of forward-looking cost models for rural carriers, stating:

> "Congress, the FCC and the Joint Board have each concluded that universal service mechanisms and policies applying such mechanisms must be flexible in recognition that market and operational factors associated with Rural Carriers may be substantially different from those associated with non-Rural Carriers. For the most part, however, the precise scope and magnitude of those differences had not been documented. Recognizing this gap in the evidentiary record, the Task Force undertook a detailed study of the 'rural differences.' Conclusions from that study are summarized in White Paper 2, 'The Rural Difference,' released by the Task Force in January 2000. White Paper 2 analyzes publicly available national data assembled for the first time, to systematically compare and contrast Rural Carriers and non-Rural Carriers. Equally important, the analysis conducted by the Task Force documents a substantial diversity among Rural Carriers themselves. An understanding of the differences between Rural Carriers and non-Rural Carriers and the diversity among Rural Carriers is key to designing appropriate mechanisms and policies which will allow the fulfillment of the 1996 Act's universal service principles."[13]

To the SCC's knowledge, the circumstances outlined in the RTF's recommendation have not appreciably changed - market and operational factors between price cap and RoR carriers are still substantially different, and there is still substantial diversity with the RoR carrier universe as well. Added to this is the fact that cost models, by their very nature, have inherent inaccuracies built in - no "model" can accurately take into account every variable involved in building, operating, and maintaining a telecommunications network. However, when the model

[13] RTF Recommendation to the Federal-State Joint Board on Universal Service, issued September 29, 2000 at pp. 10-11

is applied to larger areas, such as those served by price cap carriers, these inaccuracies can in essence be averaged out. This averaging affect will not work as well, or at all, in the smaller areas served by a substantial number of RoR carriers. This is just one example of why the SCC argues against the use of a forward-looking cost model for RoR carrier support. At the very least, more work must be done before the Commission can contemplate applying the CACM to RoR areas, even on a voluntary basis. In the interim, RoR carriers must be assured of cost recovery related to the investment required in preserving and enhancing voice and broadband services. The SCC's USFB proposal accomplishes this and more.

IV. CONCLUSION

The SCC appreciates the attention being paid by the Commission to the long-term wellbeing of voice and broadband services in areas served by RoR carriers. This issue is why the SCC exists, and the SCC has proposed what it believes to be a solution that will meet the Commission's goals, and will allow for a sufficient and predictable mechanism for RoR carriers to rely upon when making vital investment decisions. As a result, the SCC requests the Commission consider and adopt the USFB proposal as the basis for a long-term, voice and broadband-focused CAF for RoR carriers.

Respectfully Submitted,

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Small Company Coalition
Member List

ILEC Member Companies
Citizens Telephone Company of Kecksburg (PA)
Electra Telephone Company (TX)
Gorham Telephone Company (KS)
Laurel Highland Telephone Company (PA)
Mescalero Apache Telecom, Inc. (NM)
Palmerton Telephone Company (PA)
Penasco Valley Telecommunications (NM)
Sacred Wind Communications (NM)
South Canaan Telephone Company (PA)
Valley Telephone Cooperative (TX)
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