Before the

FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	GN Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
High Cost Universal Service Support	)	WC Docket No. 05-337

COMMENTS OF JOHN STAURULAKIS, INC.

July 12, 2010

TABLE OF CONTENTS

EXECUTIVE SUMMARY

In these comments, JSI demonstrates that in order for independent rural local exchange carriers ("RLECs") to continue to have the incentives to invest in their voice and broadband networks in rural areas, it is essential that the Federal Communications Commission ("FCC") reject the proposals set forth its Notice of Inquiry ("NOI") and Notice of Proposed Rulemaking ("NPRM"). If the proposals are adopted, they would destroy the incentives that RLECs have historically had to deploy high-quality voice and broadband in rural areas.

Specifically, in its NOI, the FCC indicates its predisposition to abandon the embedded cost methodology in favor of a forward-looking cost model. All modeling mechanics have flaws and obstacles, and forward-looking modeling is no exception. Given the history of modeling in the context of non-rural carriers under the existing Universal Service Fund ("USF") support structure, there is a high likelihood that use of a forward-looking cost model for broadband will produce inefficiencies and inequities in the calculation and distribution of federal USF support. To abandon the "tried and true" embedded cost method for RLECs for another methodology simply because of alluring claims of efficiency that have not been proven through actual testing and verification for rural carriers would certainly be arbitrary and capricious.

Equally as destructive, the NPRM proposes to remove any assurances that future USF support will be sufficient for RLECs by proposing to impose a cap on high-cost support and to require rate-of-return companies to transition to some form of incentive regulation. While JSI supports the concept of transitioning USF high-cost to more directly support RLECs' broadband services, the proposals set forth in the NPRM do not provide for such a path. Instead, the NPRM proposes to "eliminate" the indirect funding of broadband-capable networks that is taking place as part of the existing high-cost program. As JSI demonstrates in these comments, this reasoning is illogical and is based on an assumption that is totally false.

RLECs rely heavily on high-cost USF to maintain and upgrade their telecom and broadband networks. Accordingly, any potential loss of high-cost USF support, as envisioned by capping high-cost support at 2010 levels and converting the companies' ICLS to a frozen amount per line means revenues must come from other sources to maintain positive cash flows. As JSI explains in its comments, this would require drastic actions which would still not be enough to ensure that the companies are able to continue to provide quality and affordable telecom and broadband services. Even if RLECs are able to maintain any degree of financial viability in the face of reductions to legacy high-cost support payments, they would have no choice but to curtail all planned investment as there would not be sufficient funds to move forward with those plans.

Regarding the proposal to establish a cap on federal universal service support, JSI demonstrates that such a proposal is not in the public interest and does not address the requirement that federal policy shall take into consideration specific, predictable and sufficient Federal mechanisms. Before discussing a cap, the Commission should first address the fact that when broadband is adopted as a universal service, the contribution base will be greatly expanded which will lower the individual burden while simultaneously providing an opportunity to expand the size of the universal service budget.

JSI also demonstrates that the current “state of the art” telecom and broadband networks in rural areas have been built primarily through rate-of-return regulation of the rural telephone companies over many years and not through companies under price cap regulation. Requiring these carriers to transition away from rate-of-return regulation to price cap would eliminate the many benefits that rate-of-return regulation brings and thus be contrary to the public interest. Among these are benefits associated with provider of last resort obligations, benefits derived from efficient operations and quality of service and benefits from investment in broadband deployment.

Given the excellent track record of rate-of-return companies in deploying broadband, it would be entirely contrary to the public interest and arbitrary and capricious for the FCC to require rate-of-return companies to transition away from rate-of-return regulation to price cap regulation. Instead, the Commission should maintain the ability of RLECs to convert to price-caps on a voluntary basis. This is especially so since there are alternative ways for the Commission to address the lack of broadband deployment in price-cap areas while maintaining rate-of-return regulation for those companies that have remained under such a regime for decades.

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
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337

COMMENTS OF JOHN STAURULAKIS, INC.

John Staurulakis, Inc. ("JSI") hereby files these comments in response to the invitation of the Federal Communications Commission ("FCC" or "Commission") to comment on whether the FCC should use a model to determine universal service support levels in areas where there is no private sector business case to provide voice and broadband services ("Notice of Inquiry" or "NOI") and on proposals to reform the high-cost universal service program set forth in the Notice of Proposed Rulemaking ("NPRM") contained within the Commission's NOI/NPRM.[1]

I. Introduction

JSI is a consulting firm that assists hundreds of independent rate-of-return regulated local exchange carriers ("LECs") throughout the United States in the preparation and submission of jurisdictional cost studies and Universal Service Fund ("USF") data to the National Exchange Carrier Association ("NECA"). Additionally, JSI

[1] *Connect America Fund; A National Broadband Plan for Our Future; High-Cost Universal Service Support*; WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, Notice of Inquiry and Notice of Proposed Rulemaking, FCC 10-58 (rel. Apr. 21, 2010) ("NOI/NPRM").

offers regulatory, financial and business development services to these LECs and their affiliates. Most of these LECs and their affiliates provide broadband as well as video to a significant part of their rural service areas.

As the Commission is well aware, for many years, independent rural LECs ("RLECs") have had an excellent track record of making high-speed broadband available in rural areas. This is due primarily to the way that the existing USF high-cost program indirectly funds broadband for rate-of-return carriers which in turn provides incentives for RLECs to continue to invest in facilities that are used not only for high-quality voice but also for broadband, video and other advanced services. Similar to how one peals back the layers of the onion, one must look below the surface to understand better how the indirect funding of broadband for rate-of-return RLECs occurs before seeking to redirect funding received by these carriers for another purpose, even if that purpose is a noble one. In doing so, one discovers that in order for RLECs to continue to provide these services and to have the incentives to invest in their voice and broadband networks, two interrelated factors must continue to exist. First, it is essential that in transitioning USF to more directly support broadband, RLECs must continue to receive USF support based on an embedded cost methodology rather than via use of a yet to be developed and tested model based on forward looking economic costs. Second, RLECs must be assured that the amount of USF received will be sufficient to continue to maintain and upgrade their networks in order to provide affordable voice and data services to their subscribers and otherwise carry out their carrier of last resort obligations.

As demonstrated herein, the proposals set forth in the Commission's NOI/NPRM fail to look below the surface. As a result, if adopted they would disrupt the synergistic combination of these factors and thus destroy the incentives that RLECs have historically had to deploy high-quality voice and broadband services in rural areas. Specifically, the NOI proposes that in transitioning funds to more directly support broadband, the Commission abandon the embedded cost methodology in favor of a model. Equally as destructive, the NPRM proposes to remove any assurances that future USF support will be sufficient for RLECs by proposing to impose a cap on high-cost support and to require rate-of-return companies to transition to some form of incentive regulation. As further demonstrated herein, alternatives exist that achieve the Commission's goals of broadband availability in rural areas served by price cap carriers while allowing the synergies that have brought broadband to rural areas served by rate-of-return carriers to continue.

Accordingly, given the excellent track record of deployment of rate-of-return companies in deploying broadband to their service areas and the fact that alternatives exist that would allow these successes to continue while accomplishing the FCC's ultimate goal of universal access to broadband, it would be entirely contrary to the public interest and arbitrary and capricious for the FCC to adopt the proposals in the NOI/NPRM. The FCC should also be aware that establishing a target for universal access to broadband of four Mbps download and one Mbps upload and using that standard to determine areas that would qualify for funding from the Connect America Fund ("CAF") would be arbitrary and capricious and would further divide urban and rural areas of the nation.[2]

[2] Although it would be appropriate to address this and other issues pertaining to the CAF in a general way in these comments as the CAF forms the backdrop as to why the proposals in the NOI/NPRM have been developed, JSI will instead address these issues in comments filed in response to the *USF Transformation FNPRM* which is scheduled to be released in the fourth quarter of this year.

II. Comments on the NOI

In its NOI, the FCC asks many wide-ranging questions regarding the use of a model in the context of the yet-to-be-developed CAF. According to the NOI, such a model would assist the FCC in determining the minimum amount of USF necessary to support networks that provide broadband and voice service, "such that the contribution burden that ultimately falls on American consumers is limited."[3] Among the questions posed by the FCC are ones pertaining to the use of a model to determine support for broadband and voice when all legacy high-cost support is eventually transitioned to the CAF.[4] In posing these questions, it is blatantly obvious that whatever support there may be for existing RLEC recipients of USF in the CAF, the FCC is predisposed to not base this support on embedded cost. This is most clearly seen when the Commission cites its reasons against using an embedded cost methodology immediately after it asks for comment on whether any new CAF support should be based on forward-looking economic or historic, embedded costs.[5] However, as demonstrated below, these and other reasons given in the NOI for not continuing to use an embedded cost methodology are based on outdated findings and yet-to-be-developed rules governing the CAF. Accordingly, JSI urges the FCC to reconsider its initial conclusions and not abandon a methodology that has brought not only voice but also high-speed broadband to rural America in the most verifiably accurate manner that exists.

---

[3] NOI/NPRM at para. 13.

[4] *See, e.g., Id.* at para. 14 (seeking comment on "what modifications to the National Broadband Plan model would be required if the CAF is eventually to replace all the legacy high-cost programs") & at para.17 (seeking comment on whether the Commission should develop a nationwide broadband model "to estimate support levels in areas that are currently served by broadband with the aid of existing legacy high-cost support, as well as areas that are unserved").

[5] *Id.* at para. 23.

One of the reasons that the FCC claims that the CAF should be based on forward-looking rather than embedded costs is that this course of action would be consistent with the FCC's findings in its 1997 decision, *Universal Service First Report and Order*.[6] In that Order, the Commission found that using embedded costs to calculate support "would lead to inefficient subsidization of carriers and could create disincentives for carriers to operate efficiently."[7] Since the Commission made that finding in 1997, however, there has been a severe lack of any evidence on the record regarding any such "inefficiencies." Instead, the record is replete with evidence of the extraordinary job that RLECs have accomplished in an efficient manner in bringing high-quality voice and broadband to rural America. For example, RLECs have deployed the most efficient, state-of-the-art technologies to enable the provision of multiple services including the provision of voice, broadband and video on their networks. Their operations are carefully managed to stay within budgetary constraints with oversight from shareholders, in some cases and cooperative members in other cases. They are essential members of their communities with a keen desire and interest in operating efficiently for the betterment of their customers who are also their friends and neighbors. Accordingly, the FCC should not rely on a finding that is over twelve years old to determine whether or not the embedded cost methodology creates inefficiencies. Instead, it should examine the strong evidence that shows that this is indeed not the case.

A second reason that the FCC claims that the CAF should be based on forward-looking rather than embedded costs is that this course of action would be consistent with

[6] *Id.*
[7] *Id. citing* discussion in para. 4 which cited *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8901, para. 228 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

the National Broadband Plan's recommendation regarding CAF support levels.[8] Making such a conclusion at this early stage in the process, however, is premature. While it may be the case that use of forward-looking costs may be more consistent with this recommendation of the National Broadband Plan, at this point in time, this still remains only a "recommendation." The Commission has yet to release its *USF Transformation FNPRM* which will trigger the notice and comment period in which the actual rules of the CAF will be promulgated. Further, as the National Broadband Plan itself recognizes, the recommendation itself is subject to change.[9]

The Commission also reasons that use of a uniform federal model would be preferable to an embedded cost methodology involving submission of individual cost studies for areas currently served by broadband with the aid of legacy high-cost support.[10] The experiences of the past, however, amply demonstrate that a one-size-fits-all approach is not required and that the continued use of the embedded methodology for RLECs has been in the public interest. Under the existing high-cost structure, separate mechanisms exist for non-rural and rural carriers. The non-rural carriers operate in a sphere distinct from their rural counterparts. No evidence suggests there is a fundamental incompatibility between embedded cost calculations for RLECs and another calculation method for non-rural carriers. In fact, if experience were to judge the matter, the verdict would be that

[8] NOI/NPRM at para. 23 citing the National Broadband Plan at 145 ("Using forward looking costs is also consistent with the National Broadband Plan's recommendation that 'CAF support levels should be based on what is necessary to induce a private firm to serve an area,' and that '[s]upport should be based on the net gap (i.e., forward looking costs less revenues).'"

[9] According to the National Broadband Plan, "[t]he plan is in beta, and always will be. Like the Internet itself, the plan will always be changing – adjusting to new developments in technologies and markets, reflecting new realities, and evolving to realize unforeseen opportunities of a particular time. As such, implementation requires a long-term commitment to measuring progress and adjusting programs and policies to improve performance." National Broadband Plan, Executive Summary.

[10] NOI/NPRM at para. 17.

embedded cost is a far more efficient and fair mechanism to achieve the goals of Congress.

In sum, not only is there no support for the Commission's reasons but the NOI even admits that there has yet to be any data as to how a forward-looking cost methodology would be developed for areas with existing broadband networks or as to how forward-looking cost would be modeled, with precision, for areas currently served by RLECs. According to the NOI:

> The National Broadband Plan model does not estimate forward-looking economic costs in areas with existing broadband networks and, thus, provides no means of objectively evaluating whether current high-cost support levels are efficient, or how much support would be necessary to maintain broadband and voice services in areas currently receiving high-cost support. Nor does the National Broadband Plan model take into account any universal service support that carriers may currently receive for providing supported telephony services, whether or not they provide broadband.[11]

All modeling mechanics have flaws and obstacles, and forward-looking modeling is no exception. Given the history of modeling in the context of non-rural carriers under the existing USF structure, there is a high likelihood that use of a forward-looking cost model for broadband will produce inefficiencies and inequities in the calculation and distribution of federal universal service support. To abandon the "tried and true" embedded cost method for RLECs for another methodology simply because of alluring claims of efficiency that have not been proven through actual testing and verification for rural carriers would certainly be arbitrary and capricious. Accordingly, JSI urges the FCC to keep an open mind regarding the continued use of the embedded cost methodology for RLECs as it develops the rules for transitioning all legacy high-cost support to the CAF.

---

[11] *Id.* at para. 33.

III. Comments on the NPRM

A. The Existing High-Cost Program Indirectly Supports Broadband in an Accountable Manner

In the NPRM, the Commission seeks comment on proposals to reform the high-cost universal service program as part of the National Broadband Plan's ultimate long-range goal of "replac[ing] all the legacy High-Cost programs with a new program that preserves the connectivity that Americans have today and advances broadband in the 21st century."[12] Two of these proposals have an extremely harsh impact on RLECs – the proposal to cap high-cost support at 2010 levels and the proposal to convert the interstate common line support ("ICLS") to a frozen amount per line via a requirement that all rate of return carriers move to price caps.

The NPRM recognizes, albeit scantly, that the current high-cost program does indeed fund broadband facilities. In a footnote, the Commission acknowledges that "high-cost support for voice services <u>indirectly</u> supports the deployment of broadband capable networks."[13] This finding is consistent with the conclusion made less than two months after the FCC initiated its National Broadband Plan proceeding in a report that then Acting FCC Chairman Michael J. Copps submitted to Congress pursuant to the Farm

---

[12] *Id.* at para. 10.

[13] NOI/NPRM at n.119 (emphasis supplied). The Commission then cites the Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers , CC Docket Nos. 96-45, 00-256 Fourteenth Report and Order and Twenty-Second Order on Reconsideration, Report and Order, 16 FCC Rcd 11244, 11322, para. 200 (2001) ("The public switched telephone network is not a single-use network. Modern network infrastructure can provide access not only to voice services, but also to data, graphics, video, and other services. . . . Thus, although the high cost loop support mechanism does not support the provision of advanced services, our policies do not impede the deployment of modern plant capable of providing access to advanced services").

Bill in which it was found that "[t]he high-cost program indirectly supports the provision of broadband."[14]

While JSI supports the concept of transitioning USF high-cost to more directly support RLECs' broadband services, the proposals set forth in the NPRM do not provide for such a path. Instead, the NPRM proposes to "eliminate" the indirect funding of broadband-capable networks that is taking place as part of the existing high-cost program.[15] According to the NPRM, indirect funding of broadband should be eliminated because it is occurring "without transparency or accountability for the use of funds to extend broadband service."[16] This assumption is totally false.

Indirect funding of broadband through the existing high-cost fund takes place through the same transparent and accountable process that direct funding of legacy networks takes place. In this process, the FCC and the state commissions continue to maintain a high level of oversight. At the federal level, the Commission relies on NECA to ensure the accuracy and reasonableness of the costs submitted by virtually all rate-of-return RLECs. In almost every case, the financial information submitted to NECA has been subjected to audit by an independent audit firm. In addition, NECA employs a certification process required for every company submitting data to further ensure that all information has been maintained in accordance with the Commission's Part 32 Uniform System of Accounts ("USOA") and Part 64, Subpart I Allocation of Cost rules respecting regulated/nonregulated costs and affiliate transactions.

[14] Acting Chairman Copps Releases Report on Rural Broadband Strategy, GN Docket No. 09-29, 24 FCC Rcd 7366 (WCB 2009) ("Commissioner Copps' Report") (emphasis supplied).
[15] *Id.* at para. 53.
[16] *Id.*

As additional accountability measures, NECA randomly selects a number of companies on an annual basis for purposes of performing a more detailed "compliance" review. The compliance review process usually involves an on-site visit by NECA personnel. JSI regularly assists clients in responding to NECA compliance reviews and related requirements. Once NECA has completed its review, the data submitted constitutes the basis for the annual switched and special-access rates developed and filed with the Commission. Once filed, the access rates and all underlying cost support are available for review by any interested party.

In addition to the interstate scrutiny described above, those RLECs that are rate-of-return regulated by their respective state commissions undergo an additional level of regulatory oversight at the state level. Most state commissions require the filing of financial, demand, and service-level standards on an annual basis. In a number of states, the financial information submitted by rate-of-return regulated RLECs is formatted so the state commission can ascertain the level of dollars allocated to non-regulated activities in compliance with either the FCC's Part 64, Subpart I Allocation of Cost Rules or the state's parallel cost allocation rules, as the case may be. Moreover, in many states RLECs submit information regarding pricing of affiliate transactions in compliance with Section 32.27 of the FCC's rules or a parallel state rule. Many state commissions request provision of a cost allocation manual ("CAM") for review whenever a company seeks a change in its regulated rates or if state earnings levels are under review.

Finally, in addition to interstate and state regulatory review, independent audit firms review the financial records of virtually all rate-of-return regulated RLECs on an annual basis. Without such audits, most rate-of-return carriers would be unable to obtain financing from government-sponsored and private lending institutions necessary to maintain their networks. Accordingly, the level of review and oversight conducted throughout the entire process of assembling and providing cost support for both telecom and broadband facilities demonstrates the falsehoods inherent in the assumption that indirect funding of broadband is occurring without transparency or accountability for the use of funds to extend broadband service. JSI observes that the Commission seeks to support programs that are transparent and accountable. To this end, the Commission has at its disposal a host of universal service audits that have proven that rural rate-of-return carriers are accountable for the universal service funds they receive.

B. Proposals to Cap and Cut Will Adversely Impact the Cash Flows of RLECs

As demonstrated in comments filed in this proceeding by RLECs and their associations, RLECs rely heavily on high-cost USF to maintain and upgrade their telecom and broadband networks. Accordingly, any potential loss of high-cost USF support, as envisioned by capping high-cost support at 2010 levels and converting the companies' ICLS to a frozen amount per line means revenues must come from other sources to maintain positive cash flows. These other sources include intercarrier compensation ("ICC"), state USF where applicable, and subscriber revenues. As the Commission is fully aware, revenues from ICC are declining and state USF funds are already being fully utilized. Consequently, because the companies rely so heavily on federal USF support, any significant reduction to high-cost USF support will require actions including a combination of raising local rates, increases to the federal end user charge and significant cuts to services and operating expenses in order to maintain carrier of last resort obligations.

Such drastic actions, however, would still not be enough to ensure that the companies are able to continue to provide quality and affordable telecom and broadband services. Any local rate increases could only be modest given the lower income levels of many rural subscribers and limited local calling scopes. As for reductions in expenses, many RLECs have already undertaken extensive cuts in employee benefits and frozen the hiring of replacement staff to fill vacancies created by employee retirements. Accordingly, additional expense reductions will most likely result in employee layoffs in those communities where the telephone company is often the largest and most stable employer.

Even if RLECs are able to maintain any degree of financial viability in the face of reductions to legacy high-cost support payments, they would have no choice but to curtail all planned investment as there would not be sufficient funds to move forward with those plans. Any companies with outstanding loans and associated loan covenants would be hard pressed to have any funds available for expansion With slowing cash flows that are negative or just barely positive, RLECs would not be able to obtain loans and would have to retain any cash reserves they currently have in case they need to draw from those reserves. Already, lenders have indicated their reluctance to extend new loans to RLECs due to the proposals in the NOI/NPRM "because it is unclear whether these carriers will have sufficient future cash flows to service the debt."[17]

C. Proposal to Cap

[17] See OPASTCO Ex Parte Notice from Stuart Polikoff, Vice President of Regulatory Policy and Business Development, OPASTCO, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337, GN Docket No. 09-47, 09-51, 09-137 (May. 12, 2010).

The first item raised in the NPRM addresses a cap on the current program in an effort to control the size of the high-cost program. As demonstrated herein, the recommendation of establishing a 2010 cap on federal universal service support (adjusted only for inflation for 10 years) is not in the public interest and does not address the requirement that federal policy shall take into consideration specific, predictable and sufficient Federal mechanisms.

The reported motivation used by the National Broadband Plan for a 2010 cap is founded upon the principle of burden on customers; without recognizing that as broadband service is added as a universal service, there will be a greater number of customers and interstate revenues subject to the mandated contribution base. Broadband consumers, content providers and network providers will all benefit from a national broadband policy and interstate revenues derived from Internet connectivity services should be part of the national contribution base. Reform of the federal universal service contribution base that reflects the intent of the Act in Section 254 should be the first order of business when evaluating the National Broadband Plan. Inexplicably, the National Broadband Plan recommends the Commission examine the contribution factor and base in Stage Two of its recommendations.[18] An orderly examination of the contribution base and factor would greatly reduce the individual contribution burden while simultaneously provide the funding needed to achieve an important national broadband priority. As it stands now, the Commission has entered into the policy arena with one hand tied behind

[18] Perhaps more ironic is the fact that the recommended cap on universal service is located as a Stage Three item—well after the reform of the contribution base and factor. JSI observes that the Commission has taken the capping issue out of National Broadband Plan sequence and seeks to address the cap in Stage One of the National Broadband Plan while it is has yet to act on the contribution base and factor that will of necessity be an item for consideration when addressing whether a cap is in the public interest.

its back—certainly not an optimal position when addressing the important topic of national broadband policy.

The National Broadband Plan arbitrarily recommends a cap on federal support without any recognition that the Act recommends the following policy guideline: "There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."[19]. The only consideration the National Broadband Plan has made in forming this recommendation is a concern on the burden of end-user customers—a standard absent in the Act's Section 254. In fact, the guidance Congress gave regarding contributions was that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."[20] When broadband is adopted as a universal service, the universe of broadband providers expands and gives the Commission a great deal of flexibility in assessing contributions. This greatly expanded contribution base will lower the individual burden while simultaneously providing an opportunity to expand the size of the universal service budget to address *inter alia* the non-rural support for rural areas of the nation and the substantial middle mile costs in delivering increased broadband speeds to all rural areas of the nation.

JSI urges the Commission to reject the National Broadband Plan's recommendation of a universal service cap. It does so based on the following reasons:

1. As addressed above, the contribution base should be examined before a cap is considered.

[19] 47 U.S.C. § 254(b)(5).
[20] 47 U.S.C. §254(b)(4)

2. Ongoing operations need support to preserve universal service in both unserved and high-cost service areas.
3. New investment in unserved and underserved areas needs support to advance new provisions added to federal universal service.
4. Without further data and information, the Commission should not rely on rough and incomplete estimates to determine that our nation's broadband goals will be sufficiently met by the size of the current fund.
5. The Commission should implement efficiency goals for universal service without placing a cap on the fund.
6. The Commission should recognize the National Broadband Plan does not follow the clear direction of Congress regarding universal service.
7. The Commission does not need Congress to tell it that it may collect and distribute more funds in support of universal service. This direction is already in the Act and no Congressional action has negated this clear mandate.

In summary, JSI respectfully recommends that the Commission reject the National Broadband Plan recommendation on a cap until the foregoing items are addressed and considered. Most importantly, the Commission should address the contribution base before discussing a cap on universal service. The important policy of advancing universal service is too important to arbitrarily limit the powers Congress granted to achieve success in this effort.

D. Proposal to Cut

The current "state of the art" telecom <u>and</u> broadband networks in rural areas have been built primarily through rate-of-return regulation of the rural telephone companies over many years and not through companies under price cap regulation. This form of regulation provides many benefits including a certain level of stability and protection for consumers by enabling governing bodies to establish criteria in some areas of pricing and to ensure certain levels of service quality. Requiring these carriers to transition away from rate-of-return regulation to price cap would eliminate the many benefits that rate-of-return regulation brings and thus be contrary to the public interest.

1. Benefits Derived from Provider of Last Resort Obligations

One of those benefits is the "provider of last resort" obligations that are imposed by state regulatory authorities upon rate-of-return regulated companies. Because rate-of-return incumbent LECs have an obligation, in accordance with state regulatory authority, to serve as the provider of last resort (an obligation that extends far beyond the criteria established under eligible telecommunications carrier status), the expense associated with incumbent LEC-provided service to all customers within a specific geographic area is logically higher than that of their competitors.

Competitors can enter a market and pick-and choose to serve only those high-return customers who generate the most revenue, without concern for customers who require or demand only basic local service as their "connection" to the world. Rate of return-regulated incumbent LECs do not enjoy such a luxury. In many cases, the high cost of providing service to rural customers makes it economically inefficient for more than one carrier to provide service. As long as RLECs continue to provide the critical infrastructure needed to provision service to customers located throughout their serving territories, rate of return regulation is a prudent mechanism to ensure ubiquity of service.

The obligation to provide service to the entire service area also means that RLECs provide service to areas within their service areas that are economically depressed. These areas typically are not served by competitors who can pick-and-choose customers and service areas based on the pure profitability of the proposition. This then ensures that consumers in these areas are able to obtain affordable telecom services, including vital access to 911 and enhanced 911, through the federal USF Link-Up and Lifeline programs that are offered by the RLECs to those qualifying as low income subscribers in these areas.

2. Benefits Derived from Efficient Operations and Quality of Service

The assertion in the National Broadband Plan and the NOI/NPRM that rate-of-return regulated companies are inherently inefficient is completely inaccurate.[21] Rate-of-return regulated companies are only given the opportunity to attain a specified rate of return. There is no guarantee that a carrier will accomplish its financial goals or achieve its permissible rate of return without prudent management and efficient business decisions that are stringently reviewed by rate-of-return regulated companies' lenders, members, owners, and boards of directors. Most rate-of-return carriers continue to rely upon funding from lending institutions in order to build and maintain their network infrastructure. As with any loan arrangement, rate-of-return regulated companies must prove their financial viability and efficiency of operations to assure the lending institution that the loan will be repaid in accord with the loan covenant.

[21] USAC audit findings have even confirmed that initial findings of supposed inefficiencies of rate-of-return companies were not true. According to USAC 2009 Annual Report, USAC found that data on the first round of the audit program "supported USAC's initial report that the early estimates of 'improper' payments were too high" and reported that the final improper payment rate dropped to 2.7% from the early estimate of 16.6%.

Additionally, as previously noted in these comments, rate-of-return regulated companies are essential members of their communities with a keen desire and interest in operating efficiently for the betterment of their customers who are also their friends, neighbors, and in some cases, shareholders or cooperative members. RLECs have an excellent reputation for providing high quality, reliable, state-of-the-art telecom and broadband services with staff that can respond 24-7 to whatever communications needs that may arise.

If the high-cost USF support that RLECs receive is significantly diminished as envisioned by the NPRM, these companies would have to severely diminish the quality of the services that they provide and cease investing in their networks – possibly to the point that they cease providing services at all. The federal, state and local agencies, small businesses, rural consumers and others that rely on today's high-quality telecom and broadband infrastructure and associated services that the RLECs provide would then be forced to use lower quality and less reliable networks or would have no network at all if it is in an area of the country where no competitor has chosen to serve.

3. Benefits from Investment in Broadband Deployment

The role that rate-of-return regulation has played in advancing the deployment of broadband services is recognized in the National Broadband Plan in which it states that companies under rate-of-return regulation are able to "recoup their actual costs of extending broadband to unserved areas, including costs of deploying fiber and, for some companies, soft switches."[22] The National Broadband Plan contrasts this with companies that are under price cap regulation and admits that the amount of USF received by these carriers "do not provide an incentive for the costly upgrades that may be required to

[22] National Broadband Plan at n. 37.

deliver broadband to these customers."[23] Given the excellent track record of rate-of-return companies in deploying broadband, it would be entirely contrary to the public interest and arbitrary and capricious for the FCC to require rate-of-return companies to transition away from rate-of-return regulation to price cap regulation. Instead, the Commission should maintain the ability of RLECs to convert to price-caps on a voluntary basis. This is especially so since there are alternative ways for the Commission to address the lack of broadband deployment in price-cap areas while maintaining rate-of-return regulation for those companies that have remained under such a regime for decades.

IV. Conclusion

In these comments, JSI has demonstrated that in order for RLECs to continue to have the incentives to invest in their voice and broadband networks in rural areas, it is essential that the FCC reject the proposals set forth its NOI/NPRM. If the proposals are adopted, they would destroy the incentives that RLECs have historically had to deploy high-quality voice and broadband in rural areas without maintaining these incentives under the CAF.

Specifically, in its NOI, the FCC indicates its predisposition to abandon the embedded cost methodology in favor of a forward-looking cost model. To abandon the "tried and true" embedded cost method for RLECs for another methodology simply because of alluring claims of efficiency that have not been proven through actual testing and verification for rural carriers would certainly be arbitrary and capricious.

[23] National Broadband Plan at Chap. 8.3. The Commission notes, "funding levels for the larger carriers are based on a forward looking cost model that was designed to estimate the cost of providing circuit-switched voice services; it was never intended to address the investment necessary to extend broadband to unserved areas."

Equally as destructive, the NPRM proposes to remove any assurances that future USF support will be sufficient for RLECs by proposing to impose a cap on high-cost support and to require rate-of-return companies to transition to some form of incentive regulation. As demonstrated in these comments, alternatives exist that achieve the Commission's goals of broadband availability in rural areas served by price cap carriers while allowing the synergies that have brought broadband to rural areas served by rate-of-return carriers to continue.

Respectfully submitted,

July 12, 2010

John Staurulakis, Inc.

/s/ Manny Staurulakis
Manny Staurulakis
President
John Staurulakis, Inc.
7852 Walker Drive, Suite 200
Greenbelt, Maryland 20770