

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

In the Matter of	)	
	)	
Elimination of Rate-of-Return Regulation of Incumbent Local Exchange Carriers	)	RM 10822
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

**COMMENTS OF JOHN STAURULAKIS, INC. ON WESTERN WIRELESS CORPORATION’S PETITION OF RULEMAKING**

On November 19, 2003 the Federal Communications Commission (“FCC” or “Commission”) issued for comment a petition for rulemaking filed by Western Wireless Corporation (“WWC”) regarding the elimination of rate-of-return (“ROR”) regulation of incumbent local exchange carriers (“ILECs”).<sup>1</sup> John Staurulakis, Inc. (“JSI”) hereby files these comments opposing WWC’s petition.

JSI is a consulting firm offering regulatory and financial services to more than two hundred ILECs throughout the United States. Among its consulting services, JSI assists these ILECs in the preparation and submission of jurisdictional cost studies and Universal Service Fund (“USF”) data to the National Exchange Carrier Association (“NECA”), and routinely prepares and files tariffs with the Commission on behalf of a number of these ILECs. JSI also provides consulting services for competitive local exchange carriers (“CLECs”) that provide competitive local exchange services across the

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<sup>1</sup> Western Wireless Corporation *Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers* (October 30, 2003) (“Petition”).

nation. Since WWC's petition has the potential to dramatically alter the current federal universal service rules and to fundamentally alter the interstate regulatory landscape, JSI is an interested party in this proceeding.

## **1. Introduction**

WWC requests that the Commission open a rulemaking proceeding to determine whether the form of rate-of-return regulation used for a multitude of rural ILECs should be scuttled in favor of a forward-looking cost regulatory concept. For the reasons described herein, JSI strongly recommends that the Commission deny WWC's petition.

The foremost reason for the Commission to deny WWC's petition is that the petition itself is a mere duplication of existing proceedings before the Commission. WWC's petition attempts to duplicate the FCC's current consideration of the federal universal service program, interstate access reform, separations reform, and intercarrier compensation reviews. JSI believes that the FCC's current proceedings will address all worthwhile aspects of WWC's petition and, furthermore, will address these issues in a more comprehensive manner by recognizing the important interplay between interstate and state regulatory regimes.

In addition, WWC's petition should be denied because of the many misleading and fallacious assertions that have no justification or evidence pertaining to rural ILECs.

Rather than address each false or unsupported assertion made by WWC,<sup>2</sup> JSI urges the Commission to reject the very foundation of WWC's complaints. WWC believes incorrectly that ROR regulation guarantees a return to a select group of carriers and that ROR regulation has outlived its usefulness as an appropriate regulatory regime for rural ILECs.

## **2. WWC's Petition is Duplicative and Would Result in a Wasteful Rehash of Issues.**

After considered review of WWC's petition, JSI finds little new in WWC's allegations. Despite its verbal gesticulations, WWC's only proposal with any semblance of substance is the idea that the Commission should abandon ROR regulation in favor of forward-looking cost regulation for matters related to federal universal service support.<sup>3</sup> And even this idea is not new.

WWC's concept to move to forward-looking modeling for federal universal service support is clearly documented in pending proceedings. In its comments before the Federal-State Joint Board on Universal Service acting by referral of the FCC,<sup>4</sup> WWC

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<sup>2</sup> In its apparent knack for publicity, WWC has developed a top-ten list of reasons to abandon ROR regulation. JSI contends that every issue on this list contains errors of judgment, false assertions, or misrepresentations of facts.

<sup>3</sup> WWC also argues for the abandonment of ROR regulation for interstate access rates; however, this proposal is less than skeletal in its detail and should be considered ancillary to the central theme of WWC's petition.

<sup>4</sup> See *Federal-State Joint Board on Universal Service, Order*, CC Docket No. 96-45, 17 FCC Rcd 22642 (2002); *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, FCC 03J-1, rel. Feb. 7, 2003) (collectively referred to as the "Portability Proceeding")

states that the Joint Board Portability Proceeding “initiated a comprehensive re-examination of the system for supporting universal service in high-cost areas.”<sup>5</sup> It would serve no prudent purpose to rehash the same concepts WWC has already introduced in the Portability Proceeding in a new proceeding. The Portability Proceeding is already a “comprehensive reexamination” of the federal universal service program and has a record that already includes the ideas suggested by WWC in its petition. Arguably, based on its core arguments, the petition can be viewed as an embellished *ex parte* presentation related to the issues already under consideration in the Portability Proceeding.

WWC readily admits in its petition that there are a number of closely related pending proceedings that address the concepts reintroduced in the WWC petition.<sup>6</sup> In addition to the proceedings referenced by WWC, the Joint Board on Separations Reform proceeding recognizes the interplay of interstate and intrastate services, costs, revenues, and ILEC regulation.<sup>7</sup> Rather than open yet another proceeding that would compete with both the Commission’s and the industry’s resources in addressing the pending proceedings, JSI urges the Commission to deny WWC’s petition.

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<sup>5</sup> Comments of Western Wireless Corporation, Federal Communications Commission, CC Docket No. 96-45, electronically filed, May 5, 2003, page 1 of 152. Among other items presented by WWC are the following: New Vision of Universal Service, A Paradigm Shift in the Concept of Universal Service, Analysis of USF Distributions and Contributions, Economic Development Benefits Resulting from Competition, The Current Universal Service System, Transition to a More Efficient Universal Service System, and Consideration Of A Forward-Looking Cost Model Methodology.

<sup>6</sup> Petition at 6-7.

<sup>7</sup> *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, r, CC Docket No. 80-286. The recognition of the interplay between state and federal regulation is critical in addressing many of the issues now before the Commission.

### **3. The Commission Should Reject WWC's Protestations Concerning ROR Regulation.**

WWC vehemently protests the long-standing use of ROR regulation for rural ILECs. Among its allegations are the notions that ROR regulation guarantees a return to a select group of carriers and that ROR regulation has outlived its usefulness as a regulatory regime for rural ILECs. Both assertions are false.

#### **a. WWC grossly mischaracterizes ROR regulation.**

In an attempt to describe ROR regulation, WWC discounts its benefits. For example, WWC claims that the elimination of ROR regulation would benefit consumers through the creation of incentives for more efficient networks. This claim is without merit. ROR-regulated ILECs, since their inception, have provided immeasurable benefit to their customers through the provision of high-quality service in the most costly, lowest density, rural areas of the country. In fact, it is remarkable that while ROR-regulated ILECs serve approximately 8 percent of the access lines in the U.S., their service territories cover nearly 40 percent of the land area, where customer density averages approximately 19 access lines per square mile, compared with 128 lines per square mile for non-rural carriers.<sup>8</sup>

Because ILECs have an obligation, in accordance with state regulatory authority, to serve as the carrier of last resort (an obligation that extends far beyond the criteria

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<sup>8</sup> According to the Foundation for Rural Service (FRS), a non-profit 501(c) charitable organization affiliated with the National Telecommunications Cooperative Association ("NTCA").

established under eligible telecommunications carrier status), the expense associated with ILEC-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. ROR-regulated ILECs 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.<sup>9</sup> As long as the ROR-regulated ILECs continue to provide the critical infrastructure needed to provision service to customers located throughout their serving territories, ROR regulation is a prudent mechanism to ensure ubiquity of service.

WWC presupposes that ROR-regulated ILECs are inherently inefficient due to their ability to obtain a specified rate of return on their investments. This is completely inaccurate. It is important to note that ROR-regulated ILECs 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 ROR-regulated ILECs’ lenders, members, owners, and boards of directors. Most ROR carriers continue to rely upon funding from lending institutions in order to build and maintain their network infrastructure. As with any loan arrangement, ROR-regulated ILECs must

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<sup>9</sup> This concept of natural monopoly is clearly explained in *The Theory of Natural Monopoly*, by William R. Sharkey. The concept of natural monopoly in areas served by rural ILECs was clearly understood when Congress enacted its 1996 reforms of the Communications Act of 1934.

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. Additionally, ROR-regulated ILECs are essential members of their communities with 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.<sup>10</sup>

**b. WWC’s assertion that rural ILECs are unaudited, wasteful and abusive is false.**

WWC is apparently under the mistaken notion that ROR regulation is like an old Wild West movie – lawless and disruptive. In more than one instance, WWC alleges that ROR-regulated ILECs are unregulated, fraudulent, wasteful, and abusive in their duties and concludes that the usefulness of ROR regulation is passé. Such claims are outright fabrications regarding the state of regulatory and financial oversight in the rural telecommunications market. Among other claims, WWC asserts that: 1) the accounting records of ILECs have never been audited or scrutinized by independent auditors or regulators; 2) no extensive audit of the regulatory accounts of rural ILECs has been conducted in the past decade by the Commission, state commissions, NECA, or USAC; and, 3) NECA is not sufficiently independent to perform its oversight functions properly.

The FCC and the state commissions continue to maintain a high level of oversight that demonstrates the vital importance that rural ILECs play in providing universal

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<sup>10</sup> There are more than 250 cooperative telephone companies serving communities nationally. Most of these communities were ignored or overlooked by the Bell operating companies (BOCs) as too costly, too remote, and/or too sparsely populated to serve.

service to rural ratepayers throughout the nation. At the federal level, the Commission relies on NECA to ensure the accuracy and reasonableness of the costs submitted by virtually all rural, ROR-regulated ILECs. 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.

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. Accordingly, the level of review and oversight conducted at the federal level alone demonstrates the falsehoods inherent in WWC's petition. These facts establish that the Wild West screenplay developed by WWC is completely fictional and that ROR regulation is a fair and reasonable mechanism to further the goals of the Commission in areas served by rural ILECs.

In addition to the interstate scrutiny described above, most rural ILECs are ROR-regulated by their respective state commissions. The level of regulatory oversight at the state level is considerable. Most state commissions require the filing of financial, demand, and service-level standards on an annual basis. In fact, the examples highlighted in WWC's petition are the result of various state commission oversight activities that directly contradict the assertions made by WWC regarding the lack of scrutiny performed by regulators. In a number of states, the financial information submitted by ROR-regulated ILECs 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. Additionally, in many states ILECs submit information respecting pricing of affiliate transactions in compliance with Section 32.27 of the FCC's rules or a parallel state rule. In addition, 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. This evidence clearly demonstrates that ROR-regulated ILECs face a level of state regulatory scrutiny not acknowledged by WWC's petition.<sup>11</sup>

Finally, in addition to interstate and state regulatory review, independent audit firms review the financial records of virtually all ROR-regulated ILECs on an annual basis. Without such audits, most ROR carriers would be unable to obtain financing from government-sponsored and private lending institutions necessary to maintain their

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<sup>11</sup> In support of its claims regarding the lack of regulatory oversight and scrutiny regarding ROR regulation, WWC refers to the 1999 audits of the Bell companies' continuing property records. JSI notes that the Bell companies cited were operating under price caps at the time, not rate-of-return. JSI believes the evidence cited by WWC does not support WWC's attempt to malign ROR regulated ILECs.

networks. The assertion made by WWC that audits are not conducted or not conducted by independent auditors is false.

**c. WWC's alternative to ROR regulation for rural ILECs poses great risks.**

As has been shown, WWC's portrayal of ROR regulation is largely fiction. This fiction makes up the foundation of WWC's petition that seeks to scuttle the existing form of regulation for a forward-looking concept. The ROR regulatory processes currently in use are more than adequate to achieve the goals of the Commission and of state commissions regarding ubiquitous service and carrier-of-last-resort duties. Conversely, the alternatives suggested by WWC pose great risks. WWC asserts that forward-looking regulation would save money, create investment in innovative technologies and services, and stop alleged waste. WWC simply claims that these results would follow the adoption of forward-looking regulation. However, WWC does not explain how its "brave new world" would achieve these aims. JSI recalls that when non-rural ILECs moved to forward-looking costs for federal universal service purposes, the amount of model support for non-rural carriers was similar to that received under the older regulatory regime. Thus, WWC's claim that forward-looking cost modeling will save money does not reflect the Commission's own experience. JSI refrains from highlighting similar risks for WWC's other assertions in these comments. Rather, JSI simply attempts to highlight WWC's cavalier bias toward ROR regulation and its factual benefits. WWC's alternative is fraught with peril and provides no assurances that the goals it seeks would be reachable any more efficiently than those currently achieved.

#### 4. Summary

WWC's petition should be denied by the Commission. The issues raised by WWC in its petition are duplicative of issues in pending proceedings before the Commission. Granting WWC's petition would create a wasteful duplication of effort on the part of the Commission, the various Federal-State Joint Boards, and interested parties.

Furthermore, WWC's core allegations regarding ROR regulation have been shown to contain multiple falsehoods and mischaracterizations of the ROR regulatory process. Such allegations malign both regulators and the ROR-regulated ILECs. The goals of ROR regulation are being achieved currently. Finally, WWC's petition provides no evidence that the new and risky regulatory plan it proposes will achieve the regulatory objectives of the Commission.

Respectfully submitted,

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