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

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on	)	
Universal Service	)	

COMMENTS OF JOHN STAURULAKIS, INC.

October 15, 2004

TABLE OF CONTENTS

Summary

John Staurulakis, Inc. ("JSI") provides these comments in response to the request of the Federal-State Joint Board on Universal Service ("Joint Board") for parties to comment on certain FCC rules relating to high-cost universal service support for rural carriers serving in the states, territories and other holdings of the United States. JSI urges the Commission to consider the interrelatedness of this proceeding with other proceedings dealing with rural carriers and recommends that the Joint Board continue the use of the statutory definition of "rural carrier" for federal universal service purposes.

In its comments, JSI reviews the history and purpose of rural universal service mechanisms and encourages the Joint Board to recommend the continued use of the current embedded cost mechanisms after the expiration of the Rural Task Force plan in 2006. Lastly, JSI recommends two modifications to the current program; both of which preserve and advance universal service in areas served by rural rate-of-return local exchange carriers.

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John Staurulakis, Inc. ("JSI") hereby provides comments to the Federal-State Joint Board on Universal Service ("Joint Board") in response to the Public Notice released in the above captioned proceeding.[1] Prior to the release of the Joint Board's Public Notice, the Federal Communications Commission ("FCC" or "Commission") released its Referral Order[2] in which it requested the Joint Board to "review the Commission's rules relating to the high-cost universal service support mechanisms for rural carriers and to determine the appropriate rural mechanism to succeed the five-year plan adopted in the Rural Task Force Order."[3] Specifically, the FCC requested Joint Board recommendations to ensure that support is "specific, predictable, and sufficient to preserve and advance universal service."[4] Pursuant to the FCC's Referral Order, the Joint Board released its Public Notice, in which it announced its desire to receive

1 *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Public Notice, FCC 04J-2, rel. Aug 16, 2004. ("Public Notice").

2 *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, FCC 04-125, rel. June 28, 2004 ("Referral Order").

3 Referral Order at 1.

4 Id.

comment on certain FCC rules relating to high-cost universal service support for rural carriers serving in the states, territories and other holdings of the United States.

JSI is a consulting firm offering regulatory and financial services to more than two hundred incumbent local exchange carriers ("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 data to the National Exchange Carrier Association, 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"), which provide competitive local exchange services across the nation.

Inasmuch as the Joint Board seeks comment on federal universal service, JSI hereby files the following.

I. Introduction

The Commission historically has preserved and advanced universal service for rural carriers.[5] In May 2001, the Commission, with some modification, adopted a plan proposed by the Joint Board's Rural Task Force ("RTF") which provided that a modified embedded cost support mechanism for rural carriers would be maintained for a five-year period.[6] This five-year period will end on June 30, 2006. In its RTF Order, the

[5] *See, e.g.,* Public Notice at para. 3 *citing Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8936, para. 294 (1997) (Commission recognizing that universal service is critical to rural carriers because they "generally have higher operating and equipment costs, which are attributable to lower subscriber density, small exchanges and a lack of economies of scale").

[6] *See Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Fourteenth Report and Order and Twenty-Second Order on Reconsideration, *Multi-Association Group (MAG) Plan for Regulation*

Commission determined it would be appropriate to consider the best rural mechanism that would most efficiently and effectively achieve the goals set forth in the Telecommunications Act of 1996 prior to the expiration of the RTF plan.[7]

Pursuant to this directive, the Public Notice identifies three issues for comment: the definition of "rural" for universal service purposes; universal service support in areas served by rural telephone companies; and, support for transferred exchanges. These comments address the first of these two issues.

A. The Issues in this Proceeding Should Be Considered in Light of Other Proceedings

Prior to addressing these issues, JSI believes it is important to view this proceeding in the context of its inseverable relationship to other proceedings currently under examination by the Commission. The Commission recently received comments and reply comments concerning another set of Joint Board recommendations on universal service.[8] One issue on which comment was sought in that proceeding deals with the requirements for competitive eligible telecommunications carrier ("ETC") designation procedures. The comments of JSI and other parties in that proceeding suggest that if mandatory federal procedures are required to be used in the designation of all competitive ETCs nationally, the Commission will go a very long way to preserve and advance universal service by stemming the growth of federal universal service funds, which

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of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244, 11248 (2001) ("RTF Order").

[7] *Id.* at 11248-49.

[8] See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 04-127 (rel. June 8, 2004).

growth was noted by the Joint Board as expressly caused by the competitive ETC process.[9]

In addition to the universal service proceeding mentioned above, the Commission is also addressing intercarrier compensation issues in Docket Number 01-92.[10] The interrelatedness of universal service policy with intercarrier compensation policy is undeniable. For example, the Commission's prior action to move rural ILEC costs associated with the provision of interstate access service to a freshly minted universal service program called Interstate Common Line Support ("ICLS") demonstrates this fact. ICLS provides support for costs that are for facilities used to provide telephone exchange access, including providing exchange access to interexchange carriers ("IXCs"). If the Commission decides to move additional interstate exchange access costs – a decision in JSI's view that would be a severe error of judgment – to a universal service program without addressing corresponding impacts to rural carriers, it would raise serious public policy concerns. JSI strongly urges the Joint Board to anticipate and reflect on the interrelatedness of various related proceedings when making its recommendations to the Commission in this proceeding.[11]

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9 *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 19 FCC Rcd 4257 at para. 16 (2004)

10 *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92.

11 Another proceeding, which should be considered by the Joint Board in making its recommendations, is the docket opened by the Commission to address the regulatory status of voice over Internet protocol ("VoIP") service providers. *See IP-Enabled Services*, WC Docket No. 04-36, Notice of Proposed Rulemaking, FCC 04-28 (rel. March 10, 2004). Among the issues being considered in this proceeding include the intercarrier compensation and universal service obligations of VoIP providers.

B. The Current Mechanisms Which Allow Recovery of Costs for Rural Local Exchange Carriers Should be Considered

The federal universal service programs under review are programs and mechanisms that have a considerable track record in providing predictable and sufficient support in a manner that is efficient and practical. The touchstone of each of these rural programs, which distributes support to rural ILECs, is the realization that all costs are actual costs realized in the procurement and maintenance of a modern telecommunications network providing universal service in high cost rural areas. JSI believes a brief review of these programs provides an understanding of how rural ILEC support is used to recover costs under the current rate-of-return regulatory framework. A more complete review of all programs, including those used for non-rural carriers, can be found in an OPASTCO white paper.[12]

Federal high cost universal service support programs are mechanisms for areas served by rural ILECs. These mechanisms include: High-Cost Loop Support ("HCLS"), Local Switching Support ("LSS"), Interstate Common Line Support ("ICLS") (ICLS now includes the support program formerly known as Long-Term Support ("LTS")).

<u>High-Cost Loop Support – HCLS</u>[13]

The Commission's jurisdictional separations rules assign 25 percent of an ILEC's loop costs to the interstate jurisdiction for recovery. Loop costs refer to the costs of cable, telephone wires, poles, subscriber carrier electronics and other facilities that link

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[12] The Organization for the Promotion and Advancement of Small Telecommunications Companies, *Universal Service in Rural America: A Congressional Mandate at Risk*, Stuart Polikoff, Jan. 2003.

[13] 47 CFR Part 36, Subpart F.

each customer's premises to the public switched network, and provide subscribers with access to both intrastate and interstate telecommunications services. Rural ILECs often have high loop costs due to cost characteristics of their service areas, which are geographically large and sparsely populated.[14] This necessitates longer, more expensive loops, the costs for which must be spread over fewer customers. The Commission itself has found that the cost of providing a local loop in a rural area may be approximately 100 times greater than the cost in an urban area.[15] The HCLS mechanism (previously known as the high cost assistance fund or universal service fund) provides cost recovery for a rural telephone company's actual unseparated loop costs that are in excess of 115 percent of the national average cost per loop.[16] Although funded federally, HCLS serves directly to reduce the intrastate costs of service. Permitting rural carriers with high loop costs to recover these costs has been instrumental in providing for rates in rural areas that are reasonable and affordable.

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[14] *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, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, FCC 01-157 at n.405 ("the Rural Task Force reports that the average density is only 13 persons per square mile for areas served by rural carriers compared with 105 persons per square mile in areas served by non-rural carriers. At the same time, the average population density varies dramatically among rural carriers").

[15] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Report and Order, *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Report and Order 16 FCC Rcd 19613, 19636, at 45 (2001).

[16] Prior to 2000, the HCLS mechanism provided high-cost loop support to both rural telephone companies and non-rural ILECs based on their actual embedded or historic costs. Beginning in 2000, non-rural ILECs began receiving support for their high-cost loops based on a mechanism that uses forward-looking costs.

Local Switching Support - LSS[17]

The LSS is a mechanism that migrated funding for local switch support from implicit funding based on access charges to an explicit support mechanism. LSS is determined based on dial equipment minute ("DEM") weighting.[18] LSS provides support to ILECs with fewer than 50,000 access lines to help defray their higher switching costs.[19] The LSS mechanism recognizes that providing interexchange access requires smaller carriers to buy switching features and functionalities over and above what would be required solely for local service for a particular geographic location. In addition, small ILECs have a smaller base of customers over which to spread the costs of switch upgrades. Accordingly, LSS allows small ILECs to assign a greater proportion of their network switching costs to the interstate jurisdiction for recovery. Historically, the LSS mechanism has helped to encourage the deployment of digital switching and digital networks in rural service areas.

[17] 47 CFR § 54.301.

[18] As the implicit support was based essentially on the same DEM weighting method, the former implicit support mechanism was commonly called "DEM weighting."

[19] Prior to 1998, LSS was recovered through higher interstate access charges paid by IXCs. Today it is recovered through a federal universal service program.

Interstate Common Line Support[20]

The ICLS mechanism became effective on July 1, 2002 for rate-of-return regulated ILECs.[21] Its purpose is to replace revenues that were recovered through the interstate Carrier Common Line ("CCL") access charge element. The CCL access charge element primarily served to collect interstate loop costs not recovered by capped End User Common Line charges. The FCC believed the CCL charge was an inefficient cost recovery mechanism and implicit subsidy because it recovered fixed loop costs through a per-minute rate. Interstate access costs formerly recovered through the CCL rate are now recovered through a combination of higher end-user subscriber line charges ("SLCs") and the ICLS. JSI considers it important to recognize that ICLS does not provide rate-of-return ILECs with any additional revenues above that which they received prior to its implementation. It is simply a revenue-neutral shift of cost recovery that previously occurred through interstate access charges.

[20] One part of ICLS is support formerly known as Long Term Support ("LTS"). On July 1, 2004 the LTS mechanism was dissolved as a distribution mechanism. When active, the LTS mechanism provided support to the National Exchange Carrier Association ("NECA") Common Line revenue pool. It allowed ILEC members of the pool to charge a below-cost CCL interstate access rate to IXCs that is uniform for all carriers in the pool. The CCL access charge was a per-minute charge that recovered a portion of an ILEC's loop costs that were assigned to the interstate jurisdiction. Reducing the amount of loop costs that high-cost ILECs have to recover from IXCs through the CCL charge was intended to facilitate the availability of long distance service in rural areas that is reasonably comparable to the service options and rates available in urban areas.

[21] Rate-of-return regulation is designed to limit the profits an ILEC may earn from interstate access service. ILECs governed by rate-of-return regulation calculate their access charge rates using their costs and demand for access services. The ILECs are limited to recovering their costs plus a prescribed return on investment, and are potentially obligated to provide refunds if their interstate rate of return exceeds the authorized level. The current authorized rate of return is 11.25 percent. See, generally, 47 CFR Part 65.

In the early 1990s, the largest ILECs were required to switch from rate-of-return regulation to a form of incentive regulation called price caps. The access charges of these carriers originally were set at the cost of service levels that existed when they initially entered price caps. Since that time, their access rates have been limited by price indices that are adjusted annually pursuant to a formula developed by the FCC. Price cap carriers are permitted to earn returns significantly higher than those ILECs that continue to be governed by rate-of-return regulation. See 47 CFR §§ 61.41-61.59.

Based on these brief descriptions of the programs, JSI stresses the fact that the ICLS program is unique among the three rural ILEC programs. First, the ICLS is actually an interstate access cost recovery mechanism for rate of return regulated ILECs designed to recover costs of facilities used to provide access to and from the end user incurred in the provision of interstate access service.[22] It has little relationship to other programs, such as HCLS and LSS, which provide a direct level of support for local service. Thus, with respect to the object of the funding mechanism, ICLS has little, if any relation to the other high cost programs. The Commission appears to recognize the unique character of the ICLS program in the Referral Order.[23] JSI understands the tendency to clump all federal high cost programs together into one group. However, as the discussion above reveals, there is a necessity to comprehend the nuances of the various programs while attempting to examine whether these programs achieve their intended goals.

II. The Definition of Rural for Universal Service Purposes

The Joint Board seeks comment whether to continue to use the statutory definition of a "rural telephone company" to determine which carriers are rural carriers for high-cost universal service purposes.[24] Their apparent concern is whether certain large carriers unjustly benefit from the rural programs because of the potential realization of economies

[22] Although HCLS also supports loop costs, in contrast to ICLS, HCLS serves effectively as intrastate revenue allowing for affordable local service rates. Similarly, LSS is not a recovery of an interstate cost of service.

[23] The Commission recommended the Joint Board to consider modifications to "the current high-cost loop support mechanism and LSS." Referral Order at 10. It specifically omitted a reference to ICLS in seeking recommendations to any change to the embedded cost mechanisms on a going forward basis.

[24] 47 U.S.C. § 153(37)(D).

of scale and scope. JSI urges the Joint Board to not recommend a change in the use of the statutory definition. The illustrations noted by the Joint Board, while on their face may appear alarming, do not in the aggregate have a significant impact over the actual distributions of the existing support. Furthermore, the size of an ILEC receiving support, and any associated economies of scale and or scope, is directly reflected in the current distribution of support because when actual costs are used, the support basis reflects the particular scale and/or scope economies realized by an ILEC.

JSI believes parsing through alternative definitions of the term "rural carrier" is not an efficient use of the Joint Board's time and resources. The rural definition provided by Congress is a four-part definition that allows carriers to qualify in a variety of ways. The Commission's adoption of this statutory definition for federal universal service purposes does not appear to be broken. The adage of "if it ain't broken don't fix it" appears apropos for this issue. If all carriers were required to use actual costs for determining support levels, all carriers, ILEC and competitive ETC support alike, would reflect the economies of scale and scope in their universal service support funding – an objective apparently desired by the Joint Board. JSI recommends no change to the definition.

The economies of scale believed to be realized by larger carriers may also be illusory. Economies of scale for switching services, for example, will occur only when it is economically and technical feasible to connect multiple wire centers to one switch – thereby serving more customers from one switch. In certain instances switching may be consolidated and an economy of scale realized – which will be reflected in the level of support received by the rural ILEC. In other instances, the transport distances are so large as to outweigh the benefits of switch consolidation. The Commission rules recognize these circumstances and should not be altered. Again, the impact in fund distribution by tweaking the definition of what it means to be a "rural carrier" does not justify the administrative effort to develop a more refined approach.

As discussed further below, JSI believes the Joint Board approach to separate the cost basis and fund distribution into two parts is an incorrect way to approach the issue of rural carrier support. Under today's programs, the cost basis and the distribution of support are unified for rural ILECs. While a carrier may be defined a rural carrier for support purposes, the support any rural ILEC receives is based on actual costs in providing qualifying telecommunications services to customers. The Joint Board appears to be entertaining the idea of severing the link between "basis" and "distribution". JSI believes the Joint Board should disabuse itself from the idea that a severed relationship between the cost basis and distribution method is in the public interest. Proposing a system that is not unified creates an administrative complexity that is not necessary to further the purposes and goals of universal service, nor is it proven to be an efficient way to address universal service issues.[25]

[25] The experience of non-rural carriers is proof positive for this point. As expressed by Chairman Rowe in a separate statement, the attempt to use a proxy model for non-rural carriers – a method of using a separate basis and distribution method for federal universal service support – raises concerns about the reliability and benefits of a cost proxy model generally. See Public Notice, Statement of Chairman Bob Rowe.

III. Universal Service Support in Areas Served by Rural Telephone Companies

A. Actual or Embedded Cost Should Remain the Basis for Support

The Joint Board also seeks comment on how to determine universal service in areas served by rural carriers after the initial RTF plan period expires.[26] JSI supports the continued use of actual costs in determining the level and distribution of support in areas served by rural carriers. This method is the method that most clearly satisfies the statutory requirement that federal universal service support be specific, predictable and sufficient. Moreover, an actual cost basis is an effective and efficient means of achieving the goals of the Act.

The Act's goals are manifold and do not solely center on competition. The Commission in the Referral Order clearly expressed a national goal, to wit: "Congress articulated a national goal that consumers in all regions of the nation, including rural, insular, and high-cost areas, should have access to telecommunications and information services at rates that are reasonably comparable to rates charged for similar services in urban areas."[27] The Commission expressed this language as a national goal, equal to or superior to the "goal of promoting competition." Competition *per se* is not a public interest goal, rather the fruits of competition, in markets where it makes economic sense to have competition, may include an improved ability to meet customer demand for telecommunications services. The goal of the Act is to improve the economic and social wellbeing of citizens through the use of affordable telecommunications and information services. The Joint Board should insist that any recommendation it makes to the Commission have this goal in mind.

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26 Public Notice at 18.

27 Referral Order at 2.

Much has been said by naysayers – and will likely be said again in this proceeding – regarding the perils of using actual or embedded cost to achieve the goals of Congress. JSI submits that actual experience repels the charge against using embedded cost as an efficient, economical, sufficient, predictable and specific means to achieve the goals of Congress. The proxy model mechanism used for non-rural carriers has led many observers to suggest it is an imprecise and insufficient mechanism for the basis of support.

Many of the concerns raised by the Joint Board about systemic inefficiencies will only arise when one moves away from actual costs and attempts to approximate the actual costs of providing service through other means. Attempts to move from actual costs of rural ILECs to some other method of determining the basis of support will create distortions far greater than those presumed in the current system. These unforeseen repercussions can be avoided only by recommending the RTF plan for a second five-year period. This second five-year period will permit rural ILECs to base their support on actual costs of providing a modern telecommunications network capable of providing rural customers with services and features comparable to those services in urban areas of the nation.

Additional support to remain on embedded cost after the initial RTF period expires is found in the development, or lack thereof, of alternative methods of determining the basis of support. Since the RTF plan was adopted, JSI knows of very little activity in the development of a publicly available mechanism that accurately or for that matter even calculates forward-looking costs for rural ILECs. Thus, the state of the industry is nearly exactly the same as when the RTF white papers conclusively demonstrated the poor ability of models to capture the uniqueness of rural America.

There is also very little support to migrate rural ILECs to a forward-looking model because of alleged incompatibilities between forward-looking mechanics of non-rural carriers and embedded cost mechanics for rural ILECs. The experiences of the recent past amply demonstrate the compatibility of having separate mechanisms 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 rural ILECs and another calculation method for non-rural carriers. In fact, if experience were to judge the matter, the verdict would be that embedded cost is a far more efficient and fair mechanism to achieve the goals of Congress.[28]

Any proposed change to the basis of support for rural ILECs will necessarily be limited to the HCLS and LSS programs. The ICLS program is a rate-of-return interstate access fund designed to provide support for purposes uniquely tied to interstate access service. Any changes to the ICLS program would involve shortfalls in the cost recovery for interstate access service. Rural ILECs that are rate-of-return regulated would need to be given the opportunity to recover these interstate revenue shortfalls through interstate access charges. Such action would undo what the Commission has recently done regarding interstate access reform.

[28] According to USAC Fourth Quarter 2004 projections, only 10 states qualify for high-cost model non-rural support. Approximately 48 percent of this support is targeted to Mississippi. While JSI does not deny the high cost characteristics of providing service in rural Mississippi, to suggest it alone is deserving of one-half of all high cost model support for all non-rural carriers strains belief.

B. Modifications to the Embedded Cost Mechanisms

In addition to seeking comments on the basis of support, the Joint Board seeks comments on modifications to the embedded cost mechanism. JSI proposes the following modifications as improvements to the current mechanisms.

1. The Joint Board should recommend one carrier self-certification for all federal universal service programs. This self-certification would be sent directly to the Commission and would qualify the carrier for universal service support. The current mechanism requires a self-certification for ICLS and a state certification for HCLS and LSS. JSI believes the state mechanism is wasteful and unnecessary. For those states with designation authority, the state regulatory authority would still retain control over the ETC designation process. In the event the state regulatory authority determined that a carrier was not using federal support for the intended purposes, the state regulatory authority could revoke its designation of said carrier. The current system of multiple certifications is an unnecessary overlay to the state designation process. Also, multiple certifications and multiple deadlines is administratively cumbersome and should be streamlined. It would be in the public interest to have carriers self-certify for the three distinct federal programs HCLS, LSS, and ICLS, as applicable, with the Commission on an annual basis.

2. The Joint Board should recommend the cap of the growth of the HCLS mechanism be lifted. This cap is calculated using an algorithm that does not capture the uniqueness of certain rural ILEC costs and is therefore insufficient. In the alternative, if the Joint Board believes the cap should be retained, it should rebase the cap for the

second five-year RTF period. A rebasing of the HCLS fund would at minimum accommodate the reality of current rural ILEC operations.

IV. Conclusion

As demonstrated herein, the interrelatedness of this proceeding with other proceedings dealing with rural carriers must be considered when examining the issues under consideration in this proceeding. Further, it is critical that the Joint Board continue the use of the statutory definition of "rural carrier" for federal universal service purposes.

JSI encourages the Joint Board to recommend the continued use of the current embedded cost mechanisms after the expiration of the RTF plan in 2006. JSI also recommends two modifications to the current program; both of which preserve and advance universal service in areas served by rural rate-of-return local exchange carriers.

Respectfully submitted,

October 15, 2004

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