PUBLIC NOTICE

Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

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FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE SEEKS COMMENT ON CERTAIN OF THE COMMISSION'S RULES RELATING TO HIGH-COST UNIVERSAL SERVICE SUPPORT

CC Docket No. 96-45

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Comment Date: October 15, 2004

Reply Comment Date: December 14, 2004

1. In this Public Notice, we seek comment on issues recently referred to us by the Commission, relating to the high-cost universal support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the *Rural Task Force Order*.[1] In particular, the Commission asked the Joint Board to consider whether a universal service support mechanism for rural carriers based on forward-looking economic cost estimates or embedded costs would most efficiently and effectively achieve the goals set forth in the Telecommunications Act of 1996.[2] The Commission also asked the Joint Board both to revisit the definition of "rural telephone company" for high-cost universal service support purposes and to consider consolidating multiple study areas within a state.[3] Finally, the Commission requested that the Joint Board consider whether to retain or modify section 54.305 of the Commission's rules, which concerns the amount of universal service support for transferred exchanges.[4] By this Public Notice, the Joint Board initiates its review.[5] As set forth below, we invite public comment

[1] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, FCC 04-125 (rel. June 28, 2004) (*Referral Order*) (citing *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*, 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, 16 FCC Rcd 11244 (2001) (*Rural Task Force Order*), as corrected by Errata, CC Docket Nos. 96-45, 00-256 (Acc. Pol. Div. rel. June 1, 2001)).

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act); *Referral Order*, FCC 04-125 at para. 8. The 1996 Act amended the Communications Act of 1934 (Act). 47 U.S.C. §§ 151 *et seq.*

[3] *Referral Order*, FCC 04-125 at paras. 11-12.

[4] *Id.* at para. 13. As explained below, the issue of the basis of support for competitive eligible telecommunications carriers remains before the Joint Board and will be considered in the Joint Board's instant review. *See infra* para. 35.

[5] We note also that we plan to hold an en banc hearing in November regarding issues raised by commenters. Pending the results of the en banc hearing, we may consider holding workshops to address these issues.

on whether these rules continue to fulfill their intended purposes, whether modifications are warranted, and if so, how the rules should be modified.

I. BACKGROUND

2. In the 1996 Act, Congress directed the Commission and the states to establish support mechanisms that would ensure the delivery of affordable telecommunications service to all Americans. Among other things, section 254(b) of the Act set forth principles upon which the Commission and the Joint Board are to base their universal service policies.[6] These include the requirement that support mechanisms be specific, predictable, and sufficient to preserve and advance universal service; and that consumers in all regions have access to telecommunications and information services that are reasonably comparable to those services provided in urban areas and at reasonably comparable rates.[7]

3. The Commission's first decision implementing section 254 was its 1997 *Universal Service First Report and Order*.[8] In this order, the Commission modified existing federal support mechanisms to conform them to section 254 and determined that high-cost universal service support should be based on the forward-looking economic costs of constructing and operating the network facilities and functions used to provide the supported services.[9] The Commission recognized, however, that it was appropriate and necessary to give rural carriers[10] additional time within which to make the transition from support based on embedded, or historic, costs to support based on forward-looking costs.[11] The Commission explained that rural carriers generally have higher operating and equipment costs, which are attributable to lower subscriber density, small exchanges and a lack of economies of scale.[12] Therefore, the Commission stated that it would not implement a forward-looking support mechanism for rural carriers before January 1, 2001 and it encouraged the Joint Board to establish a task force representing a broad range of rural interests to assist in developing a forward-looking mechanism appropriate for these carriers.[13]

4. The Rural Task Force was established by the Joint Board in 1998 and was assigned the task of developing a forward-looking high-cost universal service support mechanism for rural carriers. After several years of work, including issuing six white papers, the Rural Task Force submitted its

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[6] 47 U.S.C. § 254(b).

[7] *See* 47 U.S.C. § 254(b)(3), (5).

[8] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

[9] *Id.* at 8899, para. 224.

[10] The terms "rural carrier" and "rural incumbent LEC" refer to incumbent local exchange carriers (LECs) that meet the definition of a rural telephone company set forth in section 153(37) of the Act. 47 U.S.C. § 153(37). Under this definition, rural telephone companies are incumbent LECs that either serve study areas with fewer than 100,000 access lines or meet one of three additional criteria. *See also infra* at note 23.

[11] *Universal Service First Report and Order*, 12 FCC Rcd at 8936, para. 294.

[12] *Id.*

[13] *Id.* at 8917, paras. 252-53.

Recommendation to the Joint Board in late September 2000.[14] The Joint Board agreed with the Rural Task Force's proposal and issued a Recommended Decision in late December 2000.[15] With some modification, in May 2001 the Commission adopted the Joint Board's Recommended Decision in its *Rural Task Force Order*.[16]

5. The key finding of the *Rural Task Force Order* was that the Commission would maintain a modified embedded cost support mechanism for rural carriers for a five-year period beginning on July 1, 2001.[17] The Commission stated that this five-year period, which runs through June 2006, would provide rural carriers with predictability while the Commission and the Joint Board consider the appropriate mechanism to succeed this interim plan. The Commission also stated that the long-term successor plan should better target support to rural carriers serving the highest cost areas.[18] Moreover, the Commission expressed its intention to conduct a comprehensive review of the high-cost support mechanisms for rural and non-rural carriers as a whole to ensure that both mechanisms function efficiently and in a coordinated manner.

6. In its *Referral Order*, the Commission noted that on June 30, 2006, the *Rural Task Force Order* will have been in place for five years and, therefore, it is time for the Joint Board to undertake a review of what measures should succeed the Rural Task Force (RTF) plan and how the rural and non-rural high-cost support mechanisms should function together.[19] The Commission noted that fundamental changes are occurring in the telecommunications marketplace since the Commission's rules were first adopted in 1997, necessitating a thorough review of how to preserve and advance universal service.[20] In light of these developments, the Commission asked us to review the Commission's rules for the high-cost universal support mechanisms for rural carriers and to recommend the appropriate rural mechanism to succeed the five-year plan adopted in the *Rural Task Force Order*.

II. ISSUES FOR COMMENT

7. We seek comment below on the issues referred to us by the Commission in the *Referral Order*,[21] and seek further comment on issues from the *Joint Board Recommended Decision on*

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[14] *See* Letter from William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, CC Docket No. 96-45 (filed Sept. 29, 2000).

[15] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 16 FCC Rcd 6153 (2000) (*Joint Board Rural Task Force Recommended Decision*). The Rural Task Force Recommendation is included as Appendix A to this Recommended Decision. *See id.* at 6165-6223.

[16] *See Federal-State Joint Board on Universal Service, and Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 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, 16 FCC Rcd 11244 (2001), as corrected by Errata, CC Docket Nos. 96-45, 00-256 (Acc. Pol. Div. rel. Jun. 1, 2001) (*Rural Task Force Order*), *recon. pending*.

[17] *Id.* at 11248, para. 8.

[18] *Id.* at 11248-49, paras. 8-11.

[19] *Referral Order*, FCC 04-125 at para. 7.

[20] *Id.*

[21] *Id.*

Portability.[22] We first seek comment regarding whether the Commission should continue to use the statutory definition of "rural telephone company" to determine which carriers are rural carriers for high-cost universal service support purposes. We then seek comment regarding the appropriate structure of universal service support mechanisms in areas served by rural carriers, including the cost basis of support and the method of calculating support. Finally, we seek comment regarding whether the Commission should retain, modify, or eliminate section 54.305 of its rules, which governs high-cost universal service support for transferred exchanges.

A. Definition of "Rural" for Universal Service Purposes

8. We seek comment on whether the Commission should continue to use the statutory definition of "rural telephone company" to determine which carriers are rural carriers for high-cost universal service purposes.[23] In particular, we seek comment on the extent to which each of the four subparts of the definition accurately identifies companies that "generally serve fewer subscribers, serve more sparsely populated areas, and generally do not benefit as much from economies of scale and scope" as the large non-rural carriers.[24] For example, approximately 40 companies serving study areas with more than 100,000 access lines, including one company serving over 2 million access lines, self-certified as rural carriers under subsection 3(37)(D) of the Act.[25] Most of these companies are owned by holding

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[22] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 19 FCC Rcd 4257, 4294, para. 88 (2004) (*Joint Board Recommended Decision on Portability*).

[23] Based on a Joint Board recommendation, in 1997 the Commission adopted, for universal service purposes, a definition of rural carrier that mirrored the definition of "rural telephone company" found in section 3(37) of the Act. *See* 47 U.S.C. § 153(37); *Universal Service First Report and Order*, 12 FCC Rcd at 8943-44, para. 310. Pursuant to this definition, a rural telephone company is a local exchange carrier operating entity to the extent that the entity:

> (A) Provides common carrier service to any local exchange carrier study area that does not include either:
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> > (i) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
> > (ii) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;
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> (B) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;
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> (C) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or
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> (D) Has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.

[24] *Referral Order*, FCC 04-125 at para. 3 (citing *Universal Service First Report and Order*, 12 FCC Rcd at 8936, para. 294). For many rural carriers, universal service support provides a large share of the carriers' revenues, so any sudden change in the support mechanisms may disproportionately affect rural carriers' operations. *Id.* For these reasons, the Commission determined that rural carriers should gradually shift to a forward-looking economic cost methodology on a different time-table than non-rural carriers.

[25] *See Common Carrier Bureau Releases List of Carriers Filing Rural Certification Letters and Notifications of Changes in Status*, Public Notice, CC Docket No. 96-45, 15 FCC Rcd 13872 (2000). Sprint certified that 20 of its study areas in 17 states are rural under subsection 3(37)(D). Sprint Florida serves more than 2 million lines. In the *Tenth Report and Order*, the Commission eliminated the annual filing requirement for carriers serving fewer than 100,000 access lines that have self-certified as rural, unless changes occur in their status as rural carriers. The Commission required carriers serving study areas with more than 100,000 access lines to file rural self-certifications in 2000 explaining how they meet the criteria in subsections 3(37)(A) or (D). Thereafter, such carriers are required to file only in the event of a change in their status. *See Federal-State Joint Board on Universal Service, Forward-*

companies that have operations in many states. On the other hand, companies that serve only one study area in one state, but exceed the 100,000 access line threshold in subsection 3(37)(C), are considered to be non-rural carriers.[26]

9. We seek comment on whether the Commission should continue to use subsection 3(37)(D) to identify rural carriers for high-cost universal service purposes despite the anomalies resulting from carriers self-certifying under this test. There being no statutory requirement that the Commission use the Act's definition of rural telephone company for high-cost universal service purposes, should the Commission simply eliminate this test? This likely would ensure that no study area serving more than 100,000 access lines would be considered "rural." Alternatively, would some other method be preferable? Is there some universal service policy objective that would be served by treating a carrier with more than 100,000 lines as rural when most of those lines are in rural areas? How can we ensure that those policy objectives are met? Should the Commission interpret subsection 3(37)(D) to exclude carriers that are serving areas that are merely separate, but adjacent, communities in an urbanized area?

10. Specifically, could the Commission interpret "communities of more than 50,000" in a way that would prevent rural treatment of urbanized or suburban areas? When the Commission decided to use Census Bureau statistics for legally incorporated localities, consolidated cities, and census-designated places to define communities of more than 50,000, there was no information on the record to indicate that this definition would present any problems in the Commission's determination of a carrier's status as a rural or non-rural company.[27] The Commission declined to adopt an approach proposed by GTE that would have differentiated between lines serving metropolitan statistical areas (MSAs) and those serving rural areas.[28] We seek comment on whether we should use different Census Bureau definitions, such as MSA, urbanized area, or urban cluster, to define "communities of more than 50,000." Would using any of these broader definitions be either under-inclusive or over-inclusive in identifying companies that should be considered as rural for high-cost universal service purposes?

11. We also seek comment more generally on the extent to which the Commission should continue to use the other three parts of the statutory definition. We seek comment on whether the Commission should modify its rural/non-rural definitional framework to permit finer distinctions among carriers of different sizes or characteristics. Would using finer distinctions among carriers better recognize the great diversity among rural telephone companies? Would such distinctions be useful in more effectively targeting universal service support to rural carriers serving the highest cost areas? For example, should the Commission have different high-cost universal service support mechanisms for small, medium, and large size companies? How should the Commission determine carrier size? What other characteristics should the Commission consider in distinguishing among carriers?

Looking Mechanism for High Cost Support for Non-Rural LECs, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156, 20352, para. 443 (1999) (*Tenth Report and Order*), *affirmed*, *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001).

[26] Two examples are Roseville Telephone Company in California and Northstate Telephone Company in North Carolina, which serve 134,361 lines and 125,237 lines, respectively, according to the Universal Service Administrative Company's (USAC) most recent quarterly filing. *See* USAC Quarterly Administrative Filing 2004, Third Quarter (3Q) Appendices, HC01, HC05, at http://www.universalservice.org/overview/filings.

[27] *See Tenth Report and Order*, 14 FCC Rcd at 20357, para. 456.

[28] *See id.* at 20357, paras. 456-57

12. We seek comment on whether the Commission should continue to categorize carriers based generally upon study area size.[29] Although a carrier's study area generally corresponds to the carrier's entire service territory within a state, for various reasons a carrier may have more than one study area per state.[30] To what extent does a carrier operating multiple study areas in a given state achieve some economies of scale that are not reflected in high-cost support calculations based on separate study areas? To what extent is the fact that a single company currently has multiple study areas within a state inconsistent with the policies underlying the study area freeze? Would considering all of a company's study areas within a state for universal service support purposes better reflect the appropriate economies of scale achieved by the carrier?

13. We seek comment on whether the Commission should consider holding company size, as well as study area size, when identifying companies that generally do not benefit as much from economies of scale and scope as the large non-rural companies. Many rural carriers are the operating subsidiaries of larger holding companies that may provide some economies of scale not realized by other non-affiliated rural carriers. For example, although mid-sized rural telephone holding companies with operations in many states do not have the same buying power as the largest non-rural companies, they likely have greater economies of scale and scope than very small rural companies with only one study area. Should the Commission consider having categories of carriers for high-cost universal service purposes that would take into account all affiliated companies nationwide?

14. If the Commission were to differentiate between small, medium, and large companies for high-cost universal service purposes, how should the Commission define those sizes? Should the Commission consider using the size categories in subsections 3(37)(B)-(C) of the Act? For example, carriers with fewer than 50,000 lines could be considered small; carriers with more than 50,000 lines, but fewer than 100,000 lines, could be considered medium size; and carriers with more than 100,000 lines could be considered large. To what extent would the size categories depend on whether the Commission is considering study area, statewide operations, or nationwide operations in determining company size? Should size categories include consideration of both study area size and total company size? We invite commenters to propose alternative size categories, and number of categories, that would take into account the significant distinctions and great diversity among rural telephone companies.

15. We seek comment on what carrier characteristics, in addition to company size, the Commission should consider for purposes of determining how high-cost support should be calculated. To what extent should the Commission try to identify carriers that serve rural areas? While the test in

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[29] A rural telephone company is a "local exchange operating entity" to the extent that the entity meets one of the four tests in section 3(37). *See* 47 U.S.C. § 153(37). When the Commission interpreted the statutory term "local exchange operating entity," it concluded that the most reasonable interpretation is the actual legal entity responsible for the provision of local exchange services. *See Tenth Report and Order*, 14 FCC Rcd at 20355, para. 452. Although in most cases an operating entity will provide service to only one study area within a state, that is not always the case. If the Commission had interpreted local exchange operating entity at the study area level, it could have classified a carrier at an organizational level smaller than the actual legal entity responsible for the provision of the local exchange services (e.g., a "division" of a company). *See id.*

[30] The Commission froze all study area boundaries effective November 15, 1984, in order to prevent carriers from setting up high-cost exchanges within their existing service territory as separate study areas to maximize eligibility for high-cost universal service support, among other reasons. A carrier must apply to the Commission for a waiver of the study area boundary freeze, if it wishes to sell or purchase additional exchanges and the transaction requires the alteration of an existing study area boundary. In some cases, however, a holding company may have multiple study areas within a state if it had the multiple study areas before the freeze went into effect or if it acquired a new study area in whole and therefore did not need to change its boundaries.

subsection 3(37)(A) would exclude carriers serving urbanized areas, the tests in subsections 3(37)(B) and (C) consider only the number of lines. To what extent do these definitions permit carriers serving relatively low-cost suburban areas to receive high-cost support, merely because of their small size? Should a small carrier in an urbanized area and a small carrier in a sparsely populated rural area be treated the same for high-cost support purposes? Should the Commission try to target support more effectively to the highest cost rural areas by considering whether the area served is rural, as defined in some fashion? Should the Commission try to target support to the highest cost rural areas by comparing the costs among companies or areas and identifying the highest-cost companies or areas as rural? Should the Commission consider providing different levels of support depending on the rural nature of the area served? If commenters believe that the Commission should consider the type of area served for universal service purposes, we ask them to propose how the Commission should define "rural area."

16. Within the context of the definition of rural carrier, we seek comment on whether the Commission's universal service rules encourage carriers to provide quality, affordable services more efficiently. To what extent do the Commission's rules encourage carriers serving rural areas to achieve economies of scale and scope that may benefit consumers? To what extent do the Commission's rules encourage or discourage consolidation that may provide economies of scale and scope? To what extent does the existence of separate support mechanisms for rural and non-rural carriers create incentives or disincentives for carriers to achieve economies of scale that permit the efficient provision of quality telecommunications to consumers in rural areas at rates that are reasonably comparable to those in urban areas?

17. We also seek comment on the impact of changing the definition of rural carriers. It is possible that if a new definition of "rural" is adopted for purposes of determining high-cost support, some companies that are currently designated as rural will instead be deemed non-rural. We seek comment on how such companies should be treated. For example, should these companies receive support under the same system as applies to existing non-rural companies, or should some other methodology apply? Should there be a transition period allowing these companies to adjust to whatever new rules and support levels may apply?

B. Universal Service Support in Areas Served by Rural Carriers

18. In this section, we seek comment on how to determine universal service support in areas served by rural carriers after the end of the RTF plan on June 30, 2006.[31] We first seek comment on how the underlying costs that provide the basis for support should be determined. Specifically, we seek comment regarding whether forward-looking economic cost estimates, embedded costs, or some other method of determining costs should be used for rural carriers, how each potential method of determining costs should be implemented, and what method of determining costs should be used for competitive eligible telecommunications carriers (ETCs). Finally, we seek comment on what methodology should be used to calculate each rural carrier's support.

19. We ask that commenters, in analyzing these issues, recognize the distinction between the method of determining the cost basis of support and the method of calculating support, which together form a universal service support mechanism. For example, embedded costs have been linked, in the past, to universal service support calculated on a study area basis, while forward-looking economic cost estimates have been linked to support calculated using statewide averages. There is no requirement, however, limiting us to consideration of only those combinations. So that we may better understand all of the possible options, we encourage commenters to analyze the impact of each particular option in

[31] *See supra* para. 5.

isolation. Of course, commenters should also identify any benefits or concerns related to particular combinations of cost bases and support calculations.

1. Cost Basis of Support

a. Forward-Looking Economic Costs versus Embedded Costs

20. We seek comment on what method should be used to determine the costs associated with serving a particular area for the purposes of the rural support mechanism. In the *Universal Service First Report and Order*, the Commission agreed with the Joint Board's recommendation that forward-looking economic costs should be the basis for universal service support because, unlike embedded costs, they provide appropriate incentives for investment, entry, and innovation in the marketplace.[32] In the *Ninth Report and Order* and *Tenth Report and Order*, the Commission implemented a forward-looking support mechanism for non-rural carriers.[33] The Commission's methodology, based on the forward-looking high-cost synthesis model, has been used to determine support for non-rural carriers since January 2000.[34] However, in the *Rural Task Force Order* in 2001, the Commission acknowledged that it did not, at that time, have sufficient information to develop a forward-looking model that appropriately could be used to estimate costs in areas served by rural carriers, and retained a modified embedded cost mechanism.[35] Is it possible now to design a forward-looking model that would be appropriate to estimate costs for some or all rural carriers, or do embedded costs remain a more appropriate basis for determining the costs for all rural carriers? If embedded costs remain more appropriate, what future actions or events, if any, are necessary to make a forward-looking economic cost model viable? Is a forward-looking economic cost mechanism a viable long-term goal for areas served by rural carriers? Are there any other methods for determining a rural carrier's costs, besides a forward-looking economic cost model or embedded costs, that would be appropriate for universal service purposes?

21. We seek comment on whether a rural support mechanism that bases support on forward-looking economic cost estimates or on embedded costs more efficiently and effectively achieves the Act's goals.[36] Does basing support on forward-looking economic costs or on embedded costs better ensure the availability of telecommunications services in rural areas that are comparable to those in urban areas, in terms of both rates and quality? Does basing support on forward-looking economic costs remain integral to providing appropriate incentives for investment, innovation, and entry into the marketplace? Can

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[32] *Universal Service First Report and Order*, 12 FCC Rcd at 8899, para. 224.

[33] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Ninth Report and Order*), *remanded*, *Qwest*, 258 F.3d 1191; *Tenth Report and Order*, 14 FCC Rcd 20156.

[34] In order to comply with the directives of the Tenth Circuit Court of Appeals, the non-rural support mechanism was modified by the Commission in October 2003 in the *Remand Order*. *Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, CC Docket No. 96-45, 18 FCC Rcd 22559 (2003) (*Remand Order*), *appeal pending sub nom. Qwest Communications International Inc. v. FCC & USA*, Tenth Cir. No. 03-9617; *SBC Communications Inc. v. FCC & USA*, Tenth Cir. No. 04-9518; and *Vermont Public Service Board v. FCC & USA*, Tenth Cir. No. 04-9519.

[35] *Rural Task Force Order*, 16 FCC Rcd at 11313, para. 177.

[36] Although we anticipate that most commenters will focus on forward-looking economic costs and embedded costs, we encourage commenters to suggest other appropriate methods for estimating the costs on which rural universal service support should be based.

embedded costs be utilized in a manner that would provide appropriate incentives? We also ask commenters to address the competitive and technological neutrality of each method of determining the cost basis of support.

22. How would shifting to a mechanism based on forward-looking economic costs affect investment in facilities that are capable of providing advanced services? In the *Rural Task Force Order*, the Commission noted that the public switched telephone network is not a single-use network.[37] Modern network infrastructure can provide access not only to voice services, but also to data, graphics, video, and other services. High-cost loop support is available to rural carriers "to maintain existing facilities and make prudent facility upgrades[.]"[38] To what extent has the use of embedded costs affected the deployment of infrastructure capable of providing advanced services? Does the embedded cost mechanism create different incentives to deploy facilities that are capable of providing advanced services than the forward-looking synthesis model?

23. While mindful of our caveat above that commenters should distinguish between the method of determining the cost basis of support and the method of calculating support, we seek comment on the extent to which the choice of forward-looking economic costs or embedded costs should be considered in the context of a specific method of calculating support. For example, is there any reason that forward-looking economic costs should be utilized only as part of a mechanism that calculates support based on statewide average costs? Or should embedded costs only be used to compare study area costs to nationwide average cost benchmarks? Commenters should explain in detail why certain methods of determining costs are particularly appropriate or inappropriate for certain methods of calculating support.

24. We also seek comment on whether both embedded and forward-looking economic costs can be used when developing support levels. For example, if support is based on the results of a forward-looking economic cost model, should a company's support be capped at the level of support determined under an embedded cost system? Stated another way, should support be capped at the lesser of embedded or forward-looking costs? Would such a system provide sufficient support and create proper incentives for investment and efficiency?

25. We seek comment on whether other factors should be analyzed to determine when it is appropriate to use a cost model to determine support for a carrier. In particular, we seek comment on whether the demographics of the territory served, such as the density of customer locations, rather than the lineage of the company or the number of lines served should be used to determine whether support should be paid under a forward-looking or an embedded cost system. In addition, we seek comment on whether the relative cost characteristics of the area served should be considered in determining the cost basis of support. For example, do embedded costs provide any useful information in determining whether using a cost model is appropriate? We seek comment on what other factors, in addition to demographics and costs, should be considered in making this decision.

26. Finally, we seek comment on the impact of any proposed changes in the rural support mechanism on existing rules that limit the growth of support for rural carriers. How would existing capping mechanisms that apply to rural carrier support be affected by proposed changes in the basis of support for rural carriers? If particular changes in the basis of support are adopted, are capping mechanisms still necessary? If so, are there alternative mechanisms that would limit growth of the fund to sufficient levels, while still promoting efficiency and investment?

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[37] *Rural Task Force Order*, 16 FCC Rcd at 11322, para. 200.

[38] *Universal Service First Report and Order*, 12 FCC Rcd at 8939, para. 300.

b. Estimating Forward-Looking Economic Costs

27. If the Commission ultimately concludes that it should base support for at least some rural carriers on forward-looking economic costs, we seek comment on how to estimate forward-looking economic costs in areas served by those rural carriers. If commenters propose to base support on a forward-looking economic cost model, what factors should be considered in designing a forward-looking economic cost model for areas served by rural carriers? To what extent are these factors different, in type or degree, from the factors relevant to a model for areas served by non-rural carriers? We ask that commenters address these issues generally and emphasize that commenters need not rely on the Commission's synthesis model—which is currently used in the non-rural high-cost support mechanism—to form the basis of their comments. We seek comment regarding whether there are other methods of estimating forward-looking economic costs. If a commenter contends that some other method of estimating forward-looking economic costs would be appropriate, it should describe its proposed method in detail.

28. We also seek comment regarding the synthesis model. The Rural Task Force critiqued the synthesis model and found fault with its application to rural carriers.[39] What are the major concerns regarding the synthesis model with respect to its application to rural carriers? To what extent can those concerns be addressed through the modification or redesign of the synthesis model? We encourage commenters to discuss developments and refinements in cost modeling techniques that have occurred since the Rural Task Force evaluated forward-looking costs several years ago. Are there forward-looking cost models now available that may be superior to the synthesis model for estimating rural carriers' costs? Are geocoded data for rural carriers more readily available now than in the past?

29. Should a forward-looking economic cost model for rural carriers use different inputs than those used for non-rural carriers?[40] If so, how should the inputs differ for rural carriers? Are there additional inputs that should be considered? We note that in the non-rural mechanism a nationwide set of inputs is used. To what extent should a model for smaller carriers use input values that vary by region or locality? For example, would using inputs that reflected local or regional physical plant limitations, such as soil or rock conditions or climate, significantly improve the usefulness of a model for rural carriers? Are there other local or regional conditions that could be included in a model for rural carriers?

30. As previously discussed, the Commission has used a forward-looking cost model as part of the support mechanism for non-rural carriers since 2000. When making proposals for appropriate changes to the model for rural carriers, commenters should address whether their proposals implicate the non-rural model, and if so, how. For example, if a commenter proposes that the Commission's synthesis model should be modified before being applied to rural carriers, the commenter should also explain whether such changes are also needed as the model is applied to non-rural carriers. Is it necessary that the model or model platform that applies to rural and non-rural carriers be the same? If not, why not?

31. Should a forward-looking economic cost model reflect the availability of telecommunications provided by ETCs using wireless technology? Should there be a single model that estimates costs using

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[39] *See Rural Task Force Order*, 16 FCC Rcd at 11311-13, paras. 174-76 (discussing the Rural Task Force's analysis).

[40] In the *Rural Task Force Order*, the Commission recognized that if one uses inputs designed for non-rural companies for an analysis of rural costs, one would expect significant differences when comparing these estimates to embedded costs of rural companies. *Id.* at 11312, para. 175.

the lowest cost technology? Should there be a wireless model, in addition to a wireline model, that estimates costs only for those ETCs that use wireless technology?

32. If a forward-looking economic cost model is adopted for some or all rural telephone companies, how would it be implemented? Would there be a transition period, or could it be implemented immediately? Or should there be different implementation periods for differently sized rural carriers?

c. Measuring Embedded Costs

33. Assuming that the Commission ultimately concludes that rural carriers should continue to receive support based on embedded costs, we seek comment on whether changes should be made with respect to how embedded costs are determined, or if the current rules should be retained beyond the five years of the RTF plan. Commenters that favor changes to embedded costs should describe those changes with specificity and explain how the proposed changes would be consistent with the Act's goals. In particular, we seek comment regarding changes that would improve the reliability of the cost data or reduce the administrative burdens associated with compiling, filing, and processing cost data. Do the Commission's rules create reliable accounts of the costs of providing supported services in rural areas? What modifications, if any, would improve the incentives for rural carriers to invest in their network facilities efficiently? We also seek comment on whether there should be any changes to the manner in which average schedule companies—which do not currently file actual cost data—receive high-cost support.[41]

34. We also seek comment regarding whether there are any alternative methods of developing costs for rural carriers without requiring that rural carriers file actual cost data. For example, could proxy data like line counts, line density, or other measures be used to determine the cost of serving high-cost areas served by rural carriers?

d. Basis of Support for Competitive ETCs

35. On November 8, 2002, the Commission asked the Joint Board to review, among other things, the Commission's rules relating to high-cost support in study areas in which a competitive ETC is providing service.[42] In particular, the Commission sought the Joint Board's review of the methodology for calculating support for ETCs in competitive areas and asked the Joint Board to address the concerns raised in the *Rural Task Force Order* regarding excessive fund growth if incumbent LECs lose a significant number of lines to competitive ETCs.[43] In our Recommended Decision in response to the prior referral order, we indicated that it would be desirable to "consider possible modifications to the basis of support for all ETCs during the 'comprehensive review of the high-cost support mechanisms for rural and non-rural carriers.'"[44] We explained that our approach to harmonizing the two mechanisms for

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[41] Average schedule carriers currently receive high-cost and local switching support based on formulas proposed annually by the National Exchange Carrier Association, Inc., and approved or modified by the Commission.

[42] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 17 FCC Rcd 22642, para. 1 (2002)

[43] *Id.* at 22645-46, paras. 6-8.

[44] *See Joint Board Recommended Decision on Portability*, 19 FCC Rcd at 4294, para. 88.

rural and non-rural carriers will necessarily influence our recommendations on the basis of support in competitive areas.[45]

36. We thus again seek comment on the methodology for calculating support for ETCs in competitive study areas.[46] Specifically, we seek comment regarding whether, if multiple carriers are supported, the competitive ETC should receive support based its own costs, the incumbent's costs, the lesser of its own or the incumbent's costs, or some other estimate of costs. If the cost characteristics of the incumbent and the competitor are different, what are the consequences? If support is based on the incumbent's costs and the competitive ETC has lower costs, does that provide a fair or unfair competitive advantage to the competitive ETC? Alternatively, would providing higher per-line support to the incumbent than to the competitive ETC pose a regulatory barrier to competitive entry in rural areas? If the competitive ETC's costs are higher than the incumbent's, should the competitive ETC's support be limited to that provided to the incumbent?

37. If support should be provided to competitive ETCs based on their own costs, how should those costs be determined? Competitive LECs are not subject to the Commission's cost allocation rules. Should the Commission's cost allocation rules be extended to competitive carriers that seek to receive universal service support? How would cost studies for wireless carriers be developed? Are there other methods of calculating support in study areas with more than one ETC? In providing comment, we ask commenters to address the significant changes in the marketplace that have occurred over the past several years. We note that, in considering issues related to support for competitive ETCs, we may find that it is necessary or appropriate to address these issues separately from other issues we consider in this proceeding.

2. Calculation of Support

38. We seek comment on whether the Commission should continue to calculate high-cost support for rural carriers based on individual carriers' study area average costs.[47] Does the current rural universal service support mechanism provide appropriate incentives for investment in network facilities and functions used to provide supported services? What modifications, if any, would improve the incentives for rural carriers to invest in their network facilities efficiently? Does the current mechanism, by basing support on per-line costs, create inefficiencies by increasing support when rural carriers have declining line counts?

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[45] *Id.* at 4297, para. 95.

[46] We previously sought comment on this issue in the *2003 Joint Board Public Notice*. *See* 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, *Public Notice*, 18 FCC Rcd 1941, 1948-52, paras. 15-24 (asking, among other things, whether the Commission should calculate support for a competitive ETC based on its own costs and, if yes, should the Commission use that competitor's embedded costs or its forward-looking economic costs) (2003) (*2003 Joint Board Public Notice*). Commenters should refresh the record regarding comments sought in that Public Notice, as appropriate. We caution commenters not to rely solely on previous filings as the Joint Board stated in its Recommended Decision that it did not have "an adequate record to analyze and understand the consequences of recommending a change in the basis of support for areas served by rural carriers that face competition." *Joint Board Recommended Decision on Portability*, 19 FCC Rcd at 4297, para. 96.

[47] We sought comment above whether we should consider a carrier's statewide and/or nationwide operations in determining universal service support. *See supra* paras. 12-13. Commenters should consider how those issues may have an impact on the area over which costs should be averaged.

39. The current universal service support mechanisms for rural carriers measure investment expenses using the Commission's authorized rate-of-return on investment.[48] In addition, forward-looking cost models often apply a rate-of-return to a forward-looking rate base. For example, the Commission's synthesis model for non-rural carriers uses the Commission's authorized rate-of-return as an input for the cost of capital. We seek comment on the rates of return that should be used in those calculations for rural carriers. Should the Commission use a rate-of-return other than that currently used for calculating high-cost support for rural carriers? Should the Commission use a rate-of-return other than its authorized rate-of-return for the purpose of calculating universal service support for rural carriers?

40. Assuming that some support will continue to be based on embedded costs, we also seek comment, for all support mechanisms, on whether new limitations should be imposed or existing limitations adjusted on particular categories of investment or expense. For example, the high-cost loop support mechanism currently limits corporate operations expense. We seek comment on whether this particular limit remains appropriate or needs to be adjusted. More generally, we seek comment on whether federal support programs should include similar limitations on corporate operations or other categories of expense.

41. As demonstrated by the Rural Task Force, the size of the area over which costs are averaged and the national average cost benchmark used in the non-rural mechanism have more impact on determining overall support levels than whether those costs are forward-looking or embedded.[49] Similarly, the area over which costs are averaged and the national average cost benchmarks used in the high-cost loop support mechanism impact overall support levels. Should the Commission consider averaging costs over larger areas or smaller areas for high-cost loop support and other programs? For example, should the Commission consider calculating support based on statewide average costs or wire center costs, rather than study areas costs?

42. We seek comment on the cost benchmark or benchmarks that would be appropriate to use in future programs. If the Commission bases support on statewide costs,[50] what should be the benchmarks?

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[48] In the *MAG Order*, the Commission retained its authorized 11.25% rate of return. *See Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent LEC and IXCs*, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613, 19700-02, paras. 206-10 (2001), *recon. pending*.

[49] *See Rural Task Force Order*, 14 FCC Rcd at 11313, para. 176. The Rural Task Force's analysis demonstrated how changing the area over which costs are averaged and changing the nationwide benchmark dramatically change support amounts. That is, averaging and benchmarks have more impact on determining support levels than the cost estimates produced by the cost model used to determine non-rural support. For example, if support were averaged at the study area level, rather than at the state level, the total amount of support to rural and non-rural carriers would double the amount available under the current embedded cost mechanism. *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies: Rural Task Force White Paper 4* at 18 (*White Paper 4*). If the benchmark were 115% of the nationwide average forward-looking cost instead of 135%, the total amount of support for rural and non-rural carriers would remain approximately the same as under the current mechanism. *White Paper 4* at 17. The non-rural mechanism previously used a benchmark of 135% on the national average forward-looking cost estimated by the cost model. In the *Remand Order*, the Commission adopted a benchmark of two standard deviations above the national average cost. *See Remand Order*, 18 FCC Rcd at 22599, para. 66. The rural mechanism uses multiple benchmarks, which differ for large and smaller carriers. *See infra* note 55.

[50] The non-rural mechanism is based on statewide average costs. It previously used a benchmark of 135% on the national average forward-looking cost estimated by the cost model. In the *Remand Order*, the Commission adopted

If the Commission continues to base support on study area costs,[51] what should be the benchmarks? We also note that the high-cost loop support program uses different benchmarks based on the carrier's size. We seek comment on whether that distinction should be maintained, and if so, whether the differences in treatment of the two groups should remain as large as at present.

43. In the high-cost loop support program, the national average unseparated loop cost serves as the basis for comparing costs of individual study areas. Since 2001, the national average has been defined as $240 per line per year, adjusted for inflation.[52] We seek comment on whether this remains an appropriate policy.

44. We seek comment on whether basing support on statewide average costs, as the Commission does in the non-rural mechanism, is more consistent with the purposes of universal service support and the principles set forth in section 254 of the Act. In reaffirming its decision to use statewide average costs in the non-rural mechanism, the Commission agreed with the Joint Board that "the general framework of the non-rural mechanism, through the use of statewide average costs, reflects the appropriate division of federal and state responsibility for determining high-cost support for non-rural carriers."[53] The Commission explained that "[s]tatewide averaging effectively enables the state to support its high-cost wire centers with funds from its low-cost wire centers through implicit support mechanisms, rather than unnecessarily shifting funds from other states."[54] Does providing support to rural carriers based on study area costs rather than statewide average costs adequately take into account a state's ability to address its own universal service needs? Do states that have many rural carriers receiving federal support place greater burdens on the federal universal service fund than states that have fewer rural carriers? On the other hand, are there historical or policy reasons why the Commission should not base rural carrier support on statewide average costs?[55] The Joint Board and the Commission have recognized "that

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a benchmark of two standard deviations above the national average cost. *See Remand Order*, 18 FCC Rcd at 22599, para. 66.

[51] Rural support under the high-cost loop support program is based on study area average costs. For rural companies with 200,000 or fewer lines, the high-cost loop support mechanism provides support at 65% of incremental costs above an amount equal to 115% of the national average unseparated loop cost. It also provides support at 75% of incremental costs above an amount equal to 150% of the national average. 47 C.F.R. § 36.631(c). For companies with more than 200,000 lines, the high-cost loop support mechanism generally provides less support than for smaller companies, although many companies with more than 200,000 lines are "non-rural" companies and do not receive high-cost loop support. The program provides support at 10% of incremental costs above an amount equal to 115% of the national average unseparated loop cost. It also provides support at 30% of incremental costs above an amount equal to 160% of the national average and 60% of incremental costs above an amount equal to 200% of the national average. 47 C.F.R. § 36.631(d).

[52] 47 C.F.R. § 36.622(a).

[53] *Remand Order*, 18 FCC Rcd at 22573, para. 24.

[54] *Id.*

[55] Prior to the 1996 Act, both rural and non-rural carriers were eligible for federal support under the Commission's high-cost loop support mechanism, which provides a greater percentage of federal support to carriers with 200,000 or fewer lines. *See supra* n.51. The percentages are based on Joint Board recommendations from the 1980's that the Commission increase high-cost assistance for study areas with 200,000 lines or fewer and decrease assistance for larger study areas from previous levels. The Joint Board premised its recommendation on the assumption that larger companies have greater flexibility in how they recover above-average costs than smaller companies. *See MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Recommended Decision and Order, CC Docket Nos. 78-72, 80-286, 2 FCC Rcd 2324, 2334 (1987).

statewide averaging may not be appropriate for the high-cost mechanism providing support to rural carriers."[56]

45. We also seek comment on whether basing rural company support on wire center costs, rather than study area costs, would more effectively target support to rural carriers serving the highest cost rural areas. To what extent would basing support on wire center costs require the use of a cost model? Because embedded costs are submitted at the study area level, it likely would be administratively burdensome to calculate embedded costs at the wire center level. Even if the Commission continues to base rural company support on embedded costs, should it use a cost model to target support to the highest cost wire centers?[57] Would targeting support to wire centers be more or less effective than rural carriers' current disaggregation plans, which permit targeting support below the wire center level? Given that the overwhelming majority of rural telephone companies have chosen not to disaggregate, is further targeting of rural support necessary or desirable? Could the Commission use a cost model in conjunction with embedded costs in any other useful manner? For example, could the Commission compare embedded costs with forward-looking cost estimates to evaluate whether or not support is effectively targeted to rural telephone companies serving the highest cost areas?

46. The local switching support mechanism (LSS) provides support to carriers serving 50,000 or fewer lines, without regard to other cost characteristics of the carrier.[58] Should the LSS mechanism take switching costs into account? Is 50,000 lines in service an appropriate benchmark for eligibility for LSS? Does this condition provide appropriate incentives for rural carriers to consolidate their operations to a level where quality telecommunications services could be provided more efficiently? Is there a continued need to provide support for carriers with high switching costs, or do other high-cost mechanisms provide sufficient support for such carriers?

47. We seek comment on whether the high-cost loop support mechanism should be merged with local switching support. Additionally, we seek comment regarding whether carriers that experience high transport costs should receive support. Non-rural carriers receive support for high-cost loops, switching and transport pursuant to the non-rural high-cost mechanism. Would there be benefits to moving rural carriers to a single embedded cost mechanism that includes support for high-cost loops, switching and transport?

C. Support for Transferred Exchanges

48. Under the Commission's current rules, a carrier that acquires exchanges from an unaffiliated carrier receives universal service support for those acquired exchanges at the same per-line support levels for which the exchanges were eligible prior to the transfer.[59] The Commission adopted this rule in its *Universal Service First Report and Order* in response to its concern that until universal service support for all carriers is based on a forward-looking economic cost methodology, potential universal service support payments might unduly influence a carrier's decision to purchase exchanges from another

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[56] *See Remand Order*, 18 FCC Rcd at 22573, para. 25.

[57] Although the non-rural mechanism bases support on statewide average costs, it targets that support to the highest cost wire centers.

[58] 47 C.F.R. § 54.301.

[59] *See* 47 C.F.R. § 54.305(a).

carrier.[60] The high-cost support mechanisms that are subject to the limitations in section 54.305 include rural carrier high-cost loop support, LSS, non-rural carrier high-cost model support, and interim hold-harmless support for non-rural carriers.[61] In its *Rural Task Force Order*, the Commission modified this rule to permit an acquiring rural carrier to receive additional support (i.e., "safety valve" support) for substantial investments it made in its acquired exchanges.[62] Specifically, the safety valve mechanism enables rural carriers acquiring access lines to receive additional high-cost loop support to account for post-acquisition investments made to enhance the infrastructure of and improve the service in the acquired exchanges.[63]

49. If the Commission concludes that it should maintain separate mechanisms for rural and non-rural carriers, we seek comment on whether the Commission should retain, repeal, or further modify section 54.305 of its rules. We ask commenters to discuss the costs and benefits of retaining this rule in its current form and whether more effective alternatives exist to ensure that carriers do not purchase exchanges in order to maximize the amount of universal service support that they receive while not discouraging rural carriers, including those defined as such in this proceeding, from acquiring high-cost exchanges from carriers with low average costs. We also request comment on whether the safety valve mechanism provides sufficient incentives for investment in acquired exchanges.[64]

III. REQUEST FOR COMMENT

50. Pursuant to Sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments on or before October 15, 2004, and reply comments on or before December 14, 2004. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24121 (1998).

51. Comments filed through the ECFS can be sent as an electronic file via the Internet to http://www.fcc.gov/cgb/ecfs/. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the following words in the body of the message, "get form ." A sample form and directions will be sent in reply. Parties who choose to file by

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[60] *Universal Service First Report and Order*, 12 FCC Rcd at 8942-43, para. 308 (noting that when all carriers receive support based on forward-looking economic costs, the level of support a carrier would receive for acquiring an exchange will not be a primary factor in that carrier's decision to purchase the exchange).

[61] *See Rural Task Force Order*, 16 FCC Rcd at 11281-82, para. 92.

[62] *Id.* 16 FCC Rcd at 11281-93, paras. 91-119.

[63] *Id.* 16 FCC Rcd at 11284-93, paras. 97-119 (explaining, among other things, that safety valve support should be provided for up to 50% of any positive difference between the rural carrier's index year expense adjustment for the acquired exchanges and the subsequent year expense adjustments).

[64] We note that the National Telephone Cooperative Association has a petition for reconsideration pending with the Commission to reconsider aspects of the safety valve mechanism. *See* National Telephone Cooperative Association Petition for Reconsideration and Clarification, CC Docket No. 96-45 (filed July 5, 2001).

paper must file an original and four copies of each filing. If more than one docket or rulemaking number appear in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number.

52. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail).

53. The Commission's contractor, Natek, Inc., will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002.

-The filing hours at this location are 8:00 a.m. to 7:00 p.m.

-All hand deliveries must be held together with rubber bands or fasteners.

-Any envelopes must be disposed of before entering the building.

-Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

-U.S. Postal Service first-class mail, Express Mail, and Priority Mail should be addressed to 445 12th Street, SW, Washington, D.C. 20554.

-All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

54. In addition, one copy of each pleading must be sent to each of the following:

(1) The Commission's duplicating contractor, Best Copy and Printing, Inc, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554; website: www.bcpiweb.com; phone: 1-800-378-3160;

(2) Sheryl Todd, Telecommunications Access Policy Division, Wireline Competition Bureau, 445 12th Street, S.W. Room 5-B540, Washington, D.C. 20554; e-mail: sheryl.todd@fcc.gov.

STATEMENT OF COMMISSIONER KATHLEEN Q. ABERNATHY

Earlier this year, the Federal-State Joint Board on Universal Service issued a Recommended Decision proposing more stringent guidelines for the designation of eligible telecommunications carriers. The Recommended Decision also suggested possible changes to the practice of supporting an unlimited number of connections provided by an unlimited number of carriers. These are pivotal issues that must be addressed if the Commission is to ensure the sustainability of universal service over the long haul. As the Commission considers the Recommended Decision, this Public Notice addresses a separate yet integrally related issue: the *basis* for support in rural areas.

In 1997, the FCC determined that high-cost universal service support — for carriers of all sizes and categories — should be based on the forward-looking economic costs of providing the supported services. Yet the Commission recognized even then that developing an appropriate forward-looking cost model or alternative mechanism for smaller rural carriers would pose significant challenges. Following further scrutiny by the Rural Task Force, the Commission decided to continue to rely on embedded costs for five years based on doubts about whether the cost model used in the "non-rural" program would yield reliable estimates of costs in the areas served by rural telephone companies.

We are nearing the end of the five-year freeze. It is now necessary for the Joint Board and the Commission to work cooperatively to determine what comes next. Although a prior Commission embraced a forward-looking cost methodology for all carriers, we are launching this renewed inquiry to take a fresh look at the wisdom and feasibility of abandoning the embedded cost mechanism used to support rural telephone companies. I look forward to building a thorough record and working with my colleagues on a recommended decision.

STATEMENT OF CHAIRMAN BOB ROWE

The deployment of high quality telecommunications infrastructure and services to many parts of rural America, especially those served by carriers currently defined as "rural" for universal services purposes, is one of the signal successes of recent telecommunications policy. As always, there is much more to be done.

There are tremendous economic, regulatory, and technology challenges as this nation builds on what has been accomplished to-date. The Joint-Board's first objective in this proceeding should be to preserve and enhance what has been accomplished. We should strive to further the "no barriers" approach to deployment of advanced services articulated by the Rural Task Force, whose work we are in part revisiting.

It is possible that the Section 54.305 rules concerning treatment of transferred exchanges may continue to create unintended but substantial barriers to essential upgrades of property acquired by carriers committed to investing in order to provide top notch service. These rules may exacerbate the effects on some rural areas, formerly or currently served by "non-rural" carriers,[1] of certain policies adopted by the Commission for non-rural companies serving rural areas. I am pleased that this referral will examine treatment of transferred exchanges and these possible unintended barriers.

I am especially pleased that the Joint Board announced its intention to hold an en banc hearing as part of this proceeding, and is considering workshops to address specific issues. The general absence of structured in-person proceedings, whether traditional hearings or alternative approaches, is a core procedural weakness of telecommunications policy at the national level, and led to suboptimal results in a variety of proceedings. (It has perhaps also contributed to a certain amount of puzzlement among courts attempting to review a record developed through this process.) The Universal Service Joint Board has held en banc hearings as part of several recent referrals. These have consistently enriched the record, and have greatly facilitated the Members' understanding of the subject, and appreciation of one another's perspectives.

Part of this referral concerns the cost basis for support to rural carriers. I would not support imposing on smaller companies costing methodologies, or policies generally, that do not in my opinion always work terribly well even when applied to large companies. As pointed out by the Rural Task Force, the risk of getting it wrong is simply too great. Hippocrates was right.

I have substantial and long-standing concern about the reliability of the hybrid cost proxy model even as currently applied to large companies. For the reasons identified by the Rural Task Force, this concern is even more pronounced as to small companies.[2] Failure adequately to maintain the cost model is a significant deficiency in universal service policy. If an economic cost model is to be used for any purpose, it is irresponsible not to tend it. "An unexamined cost model is not worth using." A careful

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[1] "Non-rural companies serving rural areas," is one of the more oxymoronic terms in telecommunications, and is a consistent source of confusion and misimpression to people who "don't do what we do" on a daily basis. These are simply large companies (not necessarily "non-rural"), which in some cases serve very large numbers of rural customers.

[2] Rural Task Force White Paper 2 detailed the significant differences between rural and non-rural carriers. White Paper 4 reviewed the FCC's non-rural method and the "synthesis" model for rural companies. The Rural Task Force concluded that "the non-rural method is not sufficiently accurate to form the basis for determining each Rural Carrier's explicit support." White Paper 4, page 7. Different outcomes produced by an embedded cost method and the forward looking model are amplified by policy choices, including calculating support on a study area basis, as occurs in the rural programs, and on a statewide basis, as occurs in the non-rural program.

examination of the existing cost model, as part of or parallel to this proceeding could produce great benefits.[3] Referral to the Joint Board of economic costing questions for rural companies, and perhaps to a lesser extent the reserved portability issues concerning CETCs, would seem at last to compel attention to this subject. To be clear, policies adopted for the large company high cost fund program are outside the scope of this referral (and in some cases are under appeal). Improvements to the cost model (which is not currently subject to appeal) could be an ancillary benefit of this proceeding.[4]

Significantly, this notice highlights the issues reserved from the recently-concluded portability referral, including whether a competitive ETC should receive support based on the incumbent's cost or its own cost; and, if it's own cost, what the costing method should be. Wireless carriers currently constitute the great majority of CETCs; yet, wireless ETCs are the only significant group of support recipients for which some costing method, either embedded or forward looking, has not been implemented.[5] Prompt and rigorous work on the basis of support issues would do more to address concerns over growth in the high cost fund than would the controversial and administratively problematic primary line recommendation from the previous referral. As a result, it is in the interest of wireless ETCs for all of us to march smartly on this subject. It is also the prudent and right thing to do. Punt we no more!

Technical matters such as costing are particularly ill-suited for notice-and-comment proceedings. Costing and other factually and technically complex matters require nuts-and-bolts development, with cogent participation by subject matter practitioners. These subjects are typically ill-suited for the paper-driven reviews through which telecommunications policy is commonly developed. A series of technical workshops, organized by the Joint Board staff, would be an ideal way to get under the hood of costing issues. For discussion, an initial session could be devoted to a general overview of issues and options; another could concern embedded approaches; a third could be devoted to developments in forward looking models, including the HCPM; a fourth could specifically examine wireless costing. There are a variety of reasonable approaches to the ground rules and organization for such workshops. Outcomes and the record could then be filed with the Joint Board in this proceeding. Such an approach would aid

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[3] This is particularly true for those "non-rural" carriers that serve predominantly rural areas. Indeed, it is worth asking whether those carriers should be classified as "rural" for their rural states or study areas. This is relevant to the definition of rural, which is noticed for comment, and is potentially relevant to mitigating the unintended effects of the Section 54.305 restrictions.

[4] The 10th Circuit's Qwest v. FCC gives guidance as to how modifications to the model should be developed and implemented, and makes clear that the process due is not always the same. "(T)he FCC is not required to begin a new notice-and-comment period every time it fixes a technical bug in its computer program." 258 F.3rd 1191, 1206 (2001).

[5] It is worth noting that certain costs may differ between small and large wireless carriers, as has traditionally been recognized for landline carriers.

greatly in moving forward some of the most complicated, and oft-deferred matters with which the Commission and Joint Board must deal.

I commend the Joint Board members and staff for their great work in preparing and promptly issuing this notice, and look forward to a very productive inquiry.

STATEMENT OF COMMISSIONER KEVIN J. MARTIN

Today's public notice seeks comment on issues referred to the Federal-State Joint Board on Universal Service relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the *Rural Task Force Order*. The Commission specifically asked the Joint Board to "consider whether the current forward-looking economic cost model, used in calculating high-cost support for non-rural telephone companies, is appropriate for some or all rural telephone companies, or if some other method for estimating forward-looking economic costs would be better suited for some or all rural telephone companies."[1] I am increasingly concerned by the decision to revisit whether the Commission should adopt a universal service support mechanism for rural carriers based on hypothetical forward-looking economic costs.[2]

In establishing a universal service support mechanism based on actual costs, the Commission recognized that the forward-looking economic cost model support mechanism adopted for non-rural companies may not be appropriate for rural companies. The Rural Task Force made clear that the one of the cornerstone concepts of their recommendation "was the decision to recommend the continued use of embedded cost methods rather than the Commission's forward-looking cost model for sizing universal service support for rural carriers."[3] I questioned the Commission's use of forward-looking costs as the basis for distributing universal service support for non-rural telephone companies and would have even greater concerns if such an approach would be used to distribute support to rural companies.[4] I continue to believe we could better achieve sufficient universal service support and comparability of rates if we base our universal service support system on actual rather than forward looking costs.

While pointing to the actions of a prior Commission, some apparently advocate that this Commission should follow that same path and warmly embrace hypothetical forward-looking cost models. Without offering any evidence that this approach would provide sufficient universal service support for rural America, their call to gather yet another thorough record ignores years of actual experience that has documented the inherent infirmities of hypothetical forward-looking cost models. To continue the advocacy for hypothetical cost models—regardless of the existing evidence highlighting the harms associated with this approach—is irresponsible and inconsistent with our Congressional mandate to provide sufficient support to preserve and advance universal service. As we continue this process, I remain unwilling to embrace a methodology that would reverse the benefits that universal service has provided to consumers in rural America and put at risk America's connectivity to those residing in rural and high cost areas.

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[1] *Federal-State Joint Board on Universal Service, Order,* CC Docket No. 96-45, FCC 04-125 (rel. June 28, 2004), at para. 9.

[2] Statement of Commissioner Kevin J. Martin, *Federal-State Joint Board on Universal Service, Order,* CC Docket No. 96-45, FCC 04-125 (rel. June 28, 2004)

[3] Reply Comments of the Rural Task Force on the Rural Task Force Recommendation, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 01-08 (March 12, 2001).

[4] See, Statement of Commissioner Kevin J. Martin, *Federal-State Joint Board on Universal Service,* CC Docket 96-45, Joint Board Recommendation (adopted, Oct. 16, 2003)

STATEMENT OF COMMISSIONER JONATHAN S. ADELSTEIN

Through Section 254 of the Communications Act, Congress affirmed the broad principle that "consumers in all regions of the nation ... should have access to telecommunications and information services that are reasonably comparable to those available in urban areas and at rates that are reasonably comparable to rates charged for similar services in urban areas." With this declaration, Congress reaffirmed universal service as one of the bedrock principles of U.S. telecommunications policy.

Three years ago, the Commission adopted the *Rural Task Force Order* and reiterated that "one size does not fit all" when considering universal service support mechanisms that are appropriate for rural carriers.[1] Based on the enormous effort and valuable contributions of the Rural Task Force, the Commission adopted a modified embedded cost mechanism, concluding that this approach would preserve and advance universal service, consistent with the goals and principles of Section 254. As we move forward with this proceeding, I am mindful of the Rural Task Force's reservations about using the FCC's Synthesis Model to calculate support for rural carriers.[2] As I stated at the time of the Commission's Referral Order, the use of forward-looking cost models to calculate support for rural telephone companies gives me great pause. Given the significant questions documented by the Rural Task Force, I have serious concerns about this approach.

Our choices in this proceeding will have a dramatic affect on the ability of communities and consumers in Rural America to thrive and grow with the rest of the country. History has shown that many rural consumers would be left behind if it weren't for the support made available through our universal service policies. If we take seriously the notion that universal service encompasses an "evolving level" of services and if we are to make real our aspiration that broadband and advanced services be widely available throughout the country, we must ensure that universal service support remains "specific, predictable, and sufficient."

I look forward to working closely with my colleagues on the Joint Board as we address these critical issues.

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[1] *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*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244, 11249, para. 4 (2001) (Rural Task Force Order).

[2] *Federal-State Joint Board on Universal Service*, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, at 20 (rel. Sept. 29, 2000) (Rural Task Force Recommendation).