BEFORE THE FEDERAL COMMUNICATIONS COMMISSION

IN THE MATTER Of	)	
Federal State Joint Board	)	
For Universal Service	)	**CC DOCKET NO. 96-45**
	)	

COMMENTS OF BALHOFF & ROWE, LLC

Balhoff & Rowe, LLC ("Balhoff & Rowe") file these comments in the response to the Public Notice issued by the Federal Communications Commissions ("FCC") for the Federal-State Joint Board on Universal Service seeking comments on proposals to modify the FCC's rules relating to high-cost universal service support, CC Docket No. 96-45, FCC 05J-1, (released August 17, 2005) ("*Public Notice.")*

SUMMARY

The four proposals appear to address a common set of problems, which suggest implicit principles. From these, the proposals derive a set of recommendations, many of which are common among the proposals. The Joint Board's recommendations in this and other dockets should be politically adoptable and reasonably likely to achieve the desired results. They must take into account the initial conditions from which further reform is commencing. They should be sustainable over time. Several initial conditions should be considered, including the current allocation of federal and state responsibility, and the practical division of the federal high cost fund into three programs, for smaller rural carriers, for rural Bell Operating Company served areas, and for competitive eligible telecommunications carriers (CETCs).

High cost fund policy should continue and strengthen its primary emphasis on network support. Policy should focus on supporting robust network platforms capable of providing service and rates in rural areas that are "reasonably comparable" to that offered in urban areas. Rural carriers are not the cause of fund growth, and indeed for many rural carriers the gap is growing as support is less likely today to keep up with investment costs. Reform should be based on a correct identification of cost drivers.

Investment is increasingly difficult in rural networks. Policy confusion, regulatory risk from both harmful action and delay, and debilitating uncertainty contribute to a difficult environment for appropriate investment.

Dramatically growing support for CETCs does constitute "new money," unlike access revenue replacement received by rural LECs. If competitive ETCs are to be supported, the CETC regime requires greater clarity of purpose, discipline, and accountability. There are several ways to achieve this. Both federal and state action is required.

Support for all carriers should be based on their own costs. Rules hindering investment in acquired exchanges should be further modified to enable investment in network rehabilitation. Rural study areas should not be consolidated. The large company program should be meaningfully reformed, and fundamental deficiencies in that program should neither directly nor indirectly be visited on smaller carriers successfully carrying out the mandate of Section 254. Certain policies in the existing rural small company program should be reformed to ensure that the gap between costs and support does not continue to grow.

High cost fund support should not be block granted or awarded through a "state allocation mechanism." Formula-based allocation is the most efficient and predictable mechanism for fund distributions. The SAM is not an effective use of state commissions' capabilities. SAM-based proposals suffer both practical and legal weaknesses, and do not further the high cost fund's purposes.

Although outside the scope of this *Public Notice*, USF contribution reform is essential, and will become more critical over time. The Commission's commitment to timely reform is encouraging and should be supported.

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I. INTRODUCTION

Balhoff & Rowe, LLC is a consulting firm with over thirty years collective experience in telecommunications. The firm emphasizes financially sound solutions to public policy problems. The firm is especially focused on promoting a policy environment most conducive to high quality communications services in rural America. Rural America is served by a variety of companies, including local exchange carriers: "Tier 1" Bell Operating companies; intermediate sized companies emphasizing providing scale for high quality rural service; small independent companies, often family owned; and cooperatively owned enterprises overseen by member boards. Commercial Mobile Radio Service ("CMRS") and cable companies providing telephony and data services that serve rural areas are almost equally as diverse. Policy makers, including this Joint Board, must create systems that send appropriate signals about investment and deployment to each type of communications services provider.

Many interesting or provocative proposals have been tendered for reform of universal service, intercarrier compensation, and telecommunications policy generally. For a variety of reasons, most of these are unlikely ever to be implemented. Sometimes debate around these proposals can be illuminating, and help advance implementation of constructive action. Often, however, their pursuit is a distraction and delays implementation of constructive and achievable reform.

II. THE JOINT BOARD PROPOSALS APPEAR TO REFLECT A COMMON SET OF CONCERNS AND PRINCIPLES,AND RAISE QUESTIONS ABOUT LONG-TERM APPROACHES TO HIGH COST FUND SUPPORT.

The Joint Board's supplemental notice in this proceeding is unprecedented. It indicates the Joint Board members and staff are wrestling at a fundamental level with critical long-term and short-term issues affecting universal service systems and goals, and, by extension, all telecommunications policy. The effort is commendable.

Each of the four proposals contained in the *Public Notice* makes noteworthy contributions.[1] However, all share at least some strands of a common policy DNA. Rather than discuss each plan seriatim, our comments begin by asking what problems the four proposals appear to address, and what principles may be implied in the solutions proffered.

Close reading suggests the plan authors appear to believe that there are at least nine key problems, including:

(1) growth in the fund;

(2) too-narrow a contribution base;

(3) a problematic CETC discipline (multiple CETCs designated by the states, no cost-based approaches, and insufficient goals);

(4) difficulty maintaining a distinction in the programs affecting so-called non-rural and rural carriers;

(5) the "parent trap" spawned by 47 C.F.R. 54.305 whereby acquired properties are treated differently depending on the USF regime of the seller;

(6) jurisdictional separations that make less sense in an all-distance telephony market;

(7) insufficient recovery mechanisms for transport;

(8) intercarrier compensation reform that might put further pressure on the overall size of the Universal Service Fund ("USF"); and

(9) the problem of unpredictability that is troubling rural investments.

[1] The four plans include: 1) the State Allocation Method – Universal Service Reform Package (the "SAM Plan"); 2) the Three Stage Package for Universal Service Reform (the "Three Stage Plan"); 3) a Holistically Integrated Package (the "Holistic Plan"); and 4) the Universal Service Endpoint Reform Plan (the "USERP Plan").

The various plans adopt specific proposals that appear to be designed to respond to the problems on the basis of implicit principles. The individual plan authors appear to be stating that:

(1) fund growth must be arrested or "stabilized" (freezing per-line amounts, "State Allocation Mechanism" block grants);

(2) the contribution base should be expanded to all users of the nation's communications network;

(3) CETCs should be segregated or otherwise controlled by the states via new cost-analyses, a separate fund, etc., that reflect the differing cost-characteristics, geographic scale, functional capabilities, etc. of CETCs;

(4) the distinctions between rural and non-rural programs should be eliminated to make the program "omni-jurisdictional;"

(5) the "parent trap rules" should be eliminated so that acquired exchanges can receive some support,

(6) the distinction between state and interstate services should be erased;

(7) the entire network, including transport (critical to broadband), should be eligible for recovery;

(8) USF reform should accommodate intercarrier compensation; and

(9) the need for predictability in investment so that five-year windows are established.

Then the various plans provide *specific* approaches to resolving the problems within the context of the implicit principles.

The problems associated with the existing high-cost mechanism, the implicit principles necessary to solve those problems and the illustrative recommendations from Joint Board members designed to fix those problems are detailed in Figure 1.

Figure 1: Thematic View of Joint Board Proposals

Problems	Implicit Principles	Illustrative Recommendations
• Growth in the size of the fund	• Fund growth must be arrested or “stabilized”	• SAM block grants; consolidate study areas; freeze per-line on competitive entry; review rate comparability
• States may not assume enough of USF load	• States can/should evaluate their USF duties	• States may supplement federal USF if there is need; state-specific benchmarks using cost-of-living/income
• Contribution base that is too narrow	• Contributor base should include all network users	• Contributions required of all those that use the PSTN network
• Problematic CETC discipline	• CETCs overseen by the states	• Segregate fund of CETCs from ILECs, capped at $1B, funding based on cost-studies
• Difficulty in maintaining non-rural/rural distinction	• Eliminate distinction—so USF is omni-jurisdictional	• Change the discipline so there is no artificial distinction between rurals and non-rurals
• Parent trap—limited USF for acquired properties	• Acquired exchanges eligible for USF	• Repeal the section 54.305 rule that prevents an acquirer of a rural property from USF eligibility
• All-distance prods blur jurisdictional separations	• Intrastate and interstate distinction erased	• Abrogate the distinctions between intrastate and interstate so separations process is unnecessary
•Insufficient recovery mechanisms for transport	• Entire network, including transport eligible for USF	• Ensure all network elements are eligible for recovery including high transport costs (impt. for broadband)
•Intercarrier comp. reform pressures USF	• USF reform supports intercarrier compensation	• Provide flexibility so that USF can provide support in the reform of intercarrier discipline
•Uncertainty hurting rural investments	• Provide time frame for predictability in investment	• Generally set three-to-five year review processes to create predictable investment timeframe
Fundamental analyses		Derivative proposals

Source: Balhoff & Rowe, LLC; Joint Board Referral, August 2005.

The Joint Board members are to be commended for asking thoughtful and foundational questions about this nation’s universal service policies. Our comments will start by suggesting a framework for public policy reform. The comments will then provide data concerning key areas. Finally, they will suggest what we view to be a set of realistic and achievable reforms that could, consistent with the Joint Board’s constructive intent, move universal service policy forward as was legislated in Congress’s inspiring vision in Section 254.

III. THE JOINT BOARD SHOULD MAKE RECOMMENDATIONS THAT ARE ADOPTABLE, ACHIEVABLE, SUSTAINABLE, AND TAKE INTO ACCOUNT THE POINT AT WHICH REFORM IS COMMENCING.

The Joint Board's final set of policy recommendations should possess certain characteristics.[2]

First, the reform proposals should be politically adoptable. A variety of proposals concerning universal service, including some previously considered by the Joint Board, fail this test.

Second, the recommendations should be likely to achieve the desired policy goals for which they are intended. The reforms should reflect a clear understanding of the problems, sharply define the goals of the reforms, and evaluate the probable policy and financial outcomes, including the potential distortions that might emerge.

Third, *adoptability* and *achievability* in turn depend on an understanding of the *initial conditions* that existed at the time the policies were being considered. As with other issues in everyday life, there is a significant amount of "path dependency" in public policy. Many interesting and provocative proposals for universal service or telecommunications reform simply fail the "can you get there from here" test. As much as we might wish to start with a clean slate, we take the world as we find it.

Fourth, any set of policies should be flexible and, importantly, *sustainable* over time, as circumstances are changing in a rapidly evolving telecommunications world. These

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[2] See, Barbara Cherry, Ph.D., "The Telecommunications Economy and Regulation as Coevolvng Complex Adaptive Systems: Implications for Federalism," presented at the *32nd Telecommunications Policy Research Conferenc*e, Arlington, Virginia (October, 2004); Barbara Cherry and Johannes Bauer, "Adaptive Regulation: Contours of a Policy Model for the Internet Economy" (September 2004), presented at the *International Telecommunications Society 15th Biennial Conference,* Berlin Germany.

comments will be grounded as much as possible in what we believe to be a practical path forward, within the reach of the Joint Board and the Commission.

Among the initial conditions pertaining at this time is a division under Section 254 of federal and state responsibilities. That division, especially as to contributions to support the four universal service programs[3], is clearly under stress. The shift from "implicit" support, including access charge payments, is another important initial condition.

Perhaps the most important condition is the division of the federal high cost program into what are effectively three separate programs, one providing support to small and medium-sized "rural" carriers (the "small company program"), one providing support to Regional Bell Operating Companies serving rural areas (the "large company program"), and one supporting CETCs which are currently mainly wireless companies (the "CETC program").[4] Each of these programs is discussed below.

Small Company Program. Key support elements for small independent rural carriers are based on embedded costs incurred by the companies roughly two years before they receive support.[5] Most of the companies in the program are rate-of-return regulated. Most have specific "carrier of last resort" and other legacy regulatory obligations that are governed by state and federal law. Generally, based on reviews of the state public

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[3] The four existing universal service programs are commonly referred to as: 1) High Cost Support; 2) Low Income; 3) Health Care and 4) Schools and Libraries

[4] It is possible to break down in more detail the theoretical bases of support, element by element. Not every box on the following grid will necessarily be populated in the real world, but all could be:

	Price cap		RoR		CETC	
USF	**Non- rural**	**Rural**	**Non-rural**	**Rural**	**Non-Rural**	**Rural**
Loop	FLEC	Embedded	FLEC	Embedded	Mirrors ILEC	Mirrors ILEC
LSS	Embedded	Embedded	Embedded	Embedded	Mirrors ILEC	Mirrors ILEC
IAS	Price capped	Price capped	N/A	N/A	Mirrors ILEC	Mirrors ILEC
ICLS	N/A	N/A	Embedded	Embedded	Mirrors ILEC	Mirrors ILEC
Access	*Price capped*	*Price capped*	*Cost RoR* *NECA cost* *NECA avg. cost*	*Cost RoR* *NECA cost* *NECA avg. cost*	*Mirrors ILEC*	

[5] High Lost Loop is the key element, based on embedded costs. The access replacement programs, local switching support (LSS) and interstate common line support (ICLS), are based on projections and are subsequently reconciled to actual costs.

service commissions, the small-company levels of service are high, and the provision of advanced services (based on new network deployments) is notable in light of the geographical and other barriers with which the companies must contend. However, it is very clear that aggregate support to this group of carriers is flat overall and has actually been declining for some. We suggest that specific reforms are required to ensure that the fund is able to cope with an emerging problem which is that there are rising actual costs and diminishing support that are resulting in a widening gap which could jeopardize the public purpose.

Large Company Program. USF support for the large companies is based on forward-looking economic costs. Virtually all these companies are price capped.[6] The program and the analysis supporting the program have twice been reviewed and found wanting by the courts.[7] Key issues include use of statewide averaging, use of a high national benchmark, and gross failure to maintain the model in a way reasonably approximating real world conditions. The underlying problem is that it is increasingly difficult to average costs and revenues over large regions with disparate market conditions. Customers in many rural areas served by some large companies appear to be receiving lower levels of service and lesser access to advanced services than are their urban and suburban counterparts. This program appears to be in need of reform to ensure that all rural customers receive services and rates more comparable to those in urban areas. Such a reform should also be supportive of ongoing industry rationalization.

CETC program. USF support for CETCs is based on an "equal dollar amount per line to the incumbent" methodology, as opposed to embedded or forward-looking

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[6] Surewest and the Puerto Rican companies are rate of return regulated.
[7] *See Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001) ("*Qwest I")* and *Qwest Communs. Int'l, Inc. v.FCC*, 398 F.3d 1222 (10th Cir. 2005) ("*Qwest II").*

costs. It is based on a revenue-centric methodology, by contrast with the traditional investment-centric approach. As a result, the program appears to have been disconnected from goals in terms of network-support, as well as from systems that permitted monitoring the use of funds. Roughly ninety-seven percent of CETC funds go to wireless carriers, which for non-CETC purposes are largely unregulated and unconstrained in terms of the levels of service they provide. The program's purposes appear to be confused and inconsistently articulated, with the result being limited accountability. The program is growing rapidly, has vastly exceeded the early modest proposals for fixed customer premises equipment where wireline service is not available, and is responsible for the vast majority of marginal growth in high cost support overall. Building on the FCC's *CETC Order*[8], the program must be reformed by adopting a costing methodology based on the carrier's own costs, clarifying the program's purposes at the national level, and imposing discipline and accountability similar to that imposed through the Small Company Program.

Recommendation: *The Joint Board should focus on reforms that are adoptable, achievable, sustainable, and take into account the point at which reforms are commencing.*

IV. UNIVERSAL SERVICE SHOULD CONTINUE TO FOCUS THE PROGRAM'S PRIMARY EMPHASIS ON NETWORK SUPPORT.

Networks are expensive. Services deployed over high quality networks are relatively cheap. Wireline networks will continue to be critical infrastructure for provision of most basic and advanced services for the foreseeable future. IP applications and mobile

[8] *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket. 96-45, Report and Order, 20 FCCR 6371 (released March 17, 2005) ("*CETC Order*").

services, both depend today and for the foreseeable future on the presence of reliable wireline networks to function properly. The popular view that Internet Protocol (IP) and wireless are replacing wireline services trivializes and misrepresents the critical nature of the modern wireline network.

Networks require significant fixed investments, and wireline networks, in particular, have high fixed costs and low variable costs. Telecommunications networks include transport, central office and switching, customer loops, trucks and crews, centralized customer service centers, and other elements. Virtually all of these elements require substantial initial investment, have varying economies of scope and scale, and are not quickly scaled up or down. Further, *ongoing* expenditures are significant for maintenance, expansion, and technological improvements, contrary to the popular view that suggests that the network is built and requires little additional support.

Much policy confusion has resulted from not clearly understanding the relationship between networks and services. Virtually all network designers understand that adding and subtracting customers changes costs only at the margin, especially in the short run. The major expense and risk remain in the construction of networks, whether the customers are few or they are many, whether the product bundle is a basic service or includes multiple features. Further, the cost of deploying new services can be minor, depending on the investment and type of plant a carrier has available, but that cost is *not* a linear progression that can be calculated per subscriber. A related point is that carriers need to invest well in advance of demand—for business reasons and for public policy reasons. Thus, the voice network requires redesign to eliminate long loops, load coils, and bridge taps to provide a better data platform that benefits the individual subscriber (often relatively few at first), the community, and public policy. When there are relatively few customers, the network costs per subscriber are high, and then they generally diminish as the network is better utilized.

Particularly in the loop element, different networks will have different cost characteristics. For example, a CMRS network (which generally rides over the wireline transport network other than over the cell-subscriber's last mile), may be able to add lines with a relatively lower investment to customer ratio.

The Joint Board has previously wrestled with this policy confusion in the referral concerning covered services (what is the relation between particular services and the underlying network) and in its consideration of the primary line restriction.[9] The four *Public Notice* proposals indicate the Joint Board is at least interested in moving toward a longer-term focus on networks as robust platforms for an array of services sought by rural and urban customers alike. As described below, the Rural Task Force's "no barriers"[10] recommendation continues to be the most thoughtful and relevant public policy statement on this point.

The other side of a network-focused policy is ensuring that parties who are using the network are required to assist in paying for the network. Lawful rates should be paid. Balhoff & Rowe filed Reply Comments in the Intercarrier Compensation proceeding, and urged that a rules-based approach be implemented to deal with problems of unbillable and under-billed traffic—so-called "phantom traffic."[11] Subsequent ex parte

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[9] *In the Matter of Federal-State Joint Board on Universal Service*, Recommended Decision, CC Docket No. 96-46, 18 FCCR 3368 (released July 10, 2002).

[10] *See* Letter from William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, dated September 29, 2000 ("*RTF Recommendation*").

[11] Reply Comments on Further Notice of Proposed Rulemaking, *In the Matter of Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92 (July 20, 2005).

presentations by carriers including Verizon took issue with particular technical or definitional points, and did not fully concur as to solutions, but did report that this traffic constituted as much as twenty percent of the traffic hitting their networks.[12]

Recommendation: *The Joint Board should focus on supporting robust network platforms, capable of providing rural areas with "reasonably comparable" services as well as rates comparable to those in urban areas.*

Recommendation: *The Joint Board should support prompt implementation of a reporting and enforcement regime as part of a comprehensive network-focused approach.*

V. THE DATA VERIFY THAT RURAL CARRIERS ARE NOT THE CAUSE OF FUND GROWTH, AND INDEED THE GAP BETWEEN COSTS AND SUPPORT IS WIDENING FOR MANY RURAL CARRIERS.

The *Public Notice* proposals are clearly concerned, among other things with controlling growth in the high cost fund. Various approaches to freezing or controlling fund growth are offered for comment. Any controls should be reconciled with the purposes of universal service and closely related to the causes of fund growth. Notably, however, proposals to freeze the fund will very probably frustrate the purposes of the fund, as it is likely to increase the gap between costs and support,[13] fail to recognize the relationship between access reform and high cost fund growth and poorly associates the various high cost fund investment drivers.

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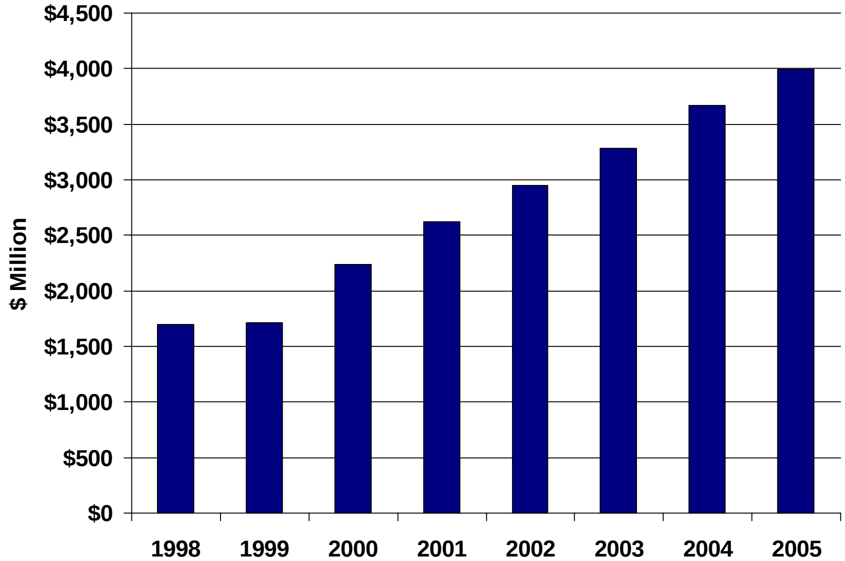
[12] Letter from Donna Epps, Vice President Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. A,, p. 8 (filed Aug. 3, 2005).
[13] A gap is already growing due to the capping of the high cost loop fund.

A ferocious debate has raged over the causes of growth in universal service, and specifically the high cost fund. As Figure 2 shows, total high cost funding has indeed gone up dramatically since 1998.

Figure 2: Total High Cost Funding, 1998 to 2005



Source: USAC 4Q05, filed 8-2-05

The step-function growth in high cost support has been tied to specific one-time events (generally phased in over several years). Past period growth is associated with, for example, adoption of the Rural Task Force recommendations[14] and the initial reform of the "large company" programs. These two changes have now been absorbed, and indeed as described below, other program elements are actually now suppressing support for many rural wireline carriers, and increasing the gap between costs necessary to provide high quality service and the support received.

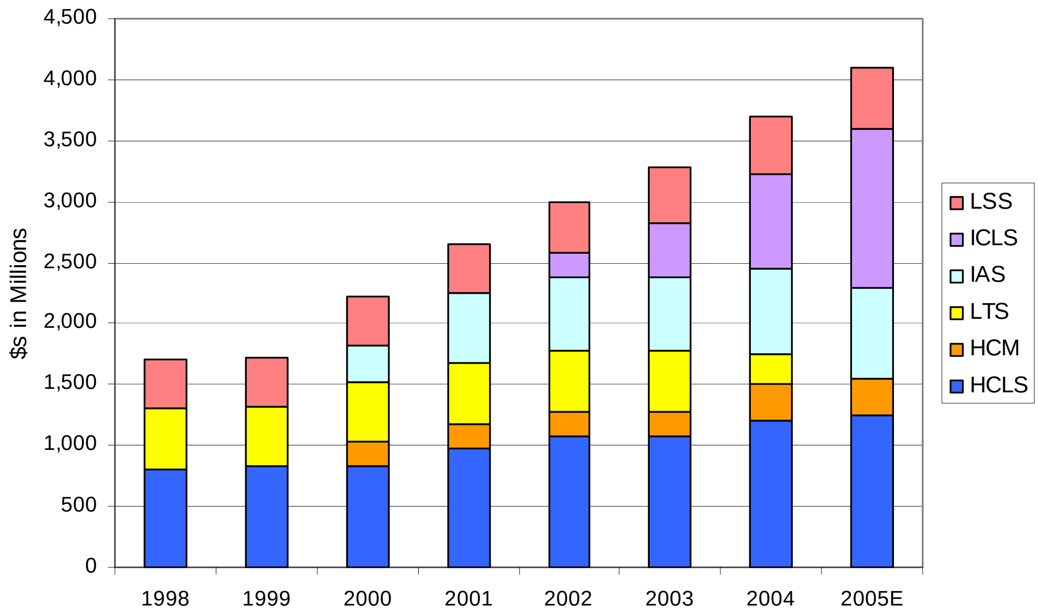
[14] *See supra*, fn. 9.

By far the largest absolute change in past period High Cost fund growth occurred in the mandated transfer from so-called implicit support in intercarrier access revenues to explicit support through high cost fund mechanisms, specifically ICLS and IAS. Importantly, however, the access reforms did not constitute new money for rural wireline carriers and were, in effect, transfers of payments from the same sources since the interexchange carriers reduced their access payments, while increasing their USF payments by virtually the same amount. The effect is that the payers paid the same amount and the recipients received the same amount, but the labels simply changed.

There was one "windfall" or new support, however, and it was created by the move to explicit access support. Under the "identical support" rule, access reform triggered payment of new funding to wireless ETCs, as wireless carriers had not received intercarrier access payments previously.[15] Figure 3 breaks out the elements of high cost fund growth over time, as they are paid to all carriers.

[15] Indeed, access reform lowered wireless and other CETC's costs, even as the identical support rule increased their universal service revenues.

Figure 3: High Cost Fund by Component 1998 to 2005

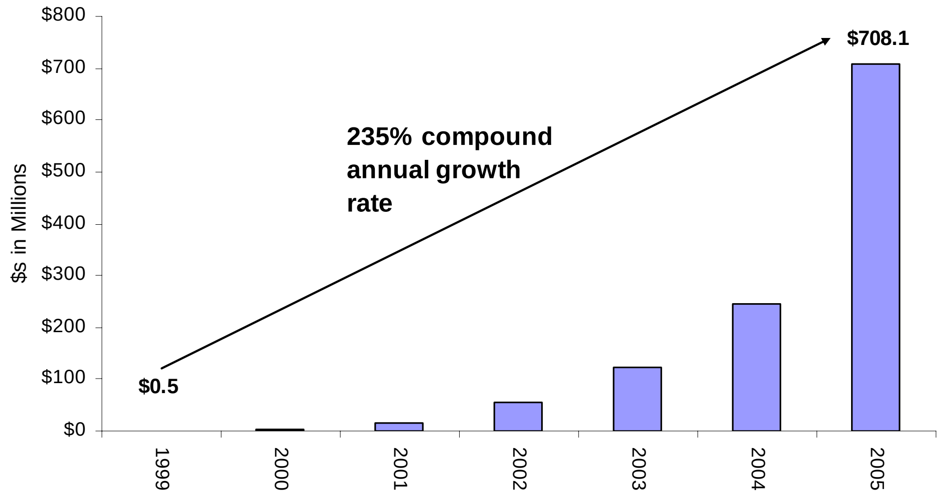


Source: Universal Service Administrative Company.

The Joint Board is now correctly seeking to harmonize universal service with intercarrier compensation reform. In doing so, it should keep in mind that past intercarrier compensation reform was a primary driver of a step-increase in high cost funding, which has been represented as "growth," in spite of the fact that these were simply transfers of payments. However, it is important to note that the reforms contributed to perceptions about sustainability of the fund, even as rural wireline carriers received no additional support as a result of these changes. Again, it is important to note that a systemic problem persists, as wireless CETCs received what some might call a "windfall" of support. Rural carriers may therefore be forgiven for being cautious about further intercarrier compensation reform if the effect is in part to paint an even larger "sustainability" target on the backs of Rural Local Exchange Carriers ("RLECs").

The reality is that the current and ongoing high cost fund growth is driven overwhelmingly by support to CETCs. CETC support is more than doubling annually, as it is estimated to be $708 million for 2005, up from approximately $244 million in 2004 and $124 million in 2003. This stunning growth is in spite of the fact that the nation's largest wireless providers have largely refrained from seeking support. Figure 4 illustrates the dramatic growth of CETC support over the last several years.

Figure 4: CETC Support, 1999 to 2005[16]



Source: USAC 4Q05, filed 8-2-05.

Both the number of CETCs and the number of study areas with CETCs has grown dramatically in the last several years. By the third quarter of 2005, there were 161 rural CETCs, certified in 747 rural study areas. As Table 1 shows, their support had increased

[16] Actual CETC support for 2005 is lower than the forecast level of $826.70 million. This appears to be primarily a result of the identical support rule, and reduced ILEC line counts. Because the ILECs report their year end line count data to NECA for USF data collection purposes on July 31st each year, consistency mandated that year end line count reporting for CETCs would be on July 31st as well. USAC is required to submit its quarterly projection for fourth quarter, sixty days prior to the start of the fourth quarter (August 2nd). As a result, the fourth quarter projection does not include the impact of growth in CETC lines for existing CETCs. USAC reflects the changes in fourth quarter support as part of the first projection for the following year. As a result, 1Q2006 numbers filed in early November will likely again begin to show growth in CETC support amounts. A similar situation occurred a year ago.

from 3.0 percent in the third quarter of 2002 to 17.8 percent of the entire high cost fund in the third quarter of 2005:

Table 1: CETC Growth 3Q02 to 3Q05

	3Q02	3Q05	CAGR
Rural CETCs	26	161	83.6%
Rural ILEC Study Areas w/ CETCS	221	747	50.1%
% of Total Rural High Cost Support	3.0%	17.8%	81.0%

Source: Universal Administrative Company, 3Q05.

Under the "identical support" rule, CETCs currently receive support for each element of the high cost fund, whether or not they have costs associated with the underlying program purposes, and whether or not, in the case of access replacement, they ever received the access-related elements. Table 2 shows the amount ILECs receive versus the amount CETCs receive in federal USF based on an annualization of the third quarter figures for 2005.

Table 2: ILEC v. CETC Support by Element

High Cost Fund	**3Q05 Annualized**			**3Q05 Annualized**		
($s in millions)	**ILEC**	**CETC**	**Total**	**ILEC**	**CETC**	**Total**
High Cost Loop	$ 1,056	$ 224	$ 1,280	82.5%	17.5%	100.0%
Interstate Common Line Support	959	283	1,242	77.2%	22.8%	100.0%
Long Term Support	-	-	-	NA	NA	NA
Local Switching Support	390	85	475	82.1%	17.9%	100.0%
High Cost Model	221	69	290	76.1%	23.9%	100.0%
Interstate Access Support	603	160	763	79.0%	21.0%	100.0%
Safety Valve Support	2	1	3	69.7%	30.3%	100.0%
Safety Net Support	13	4	16	77.9%	22.1%	100.0%
Total High Cost Fund	**$ 3,244**	**$ 826**	**$ 4,070**	**79.7%**	**20.3%**	**100.0%**

Source: Universal Service Administrative Company, 3Q05 annualized.

Access charge-related CETC support includes $282.7 million in ICLS and $160 million in IAS (3Q05, annualized), totaling $442.7 million in support associated directly with another carrier's network.[17] It is also notable that CETCs receive nearly one-third ($1 million) of all safety valve and nearly one-quarter ($3.6 million) of safety net support, figures tied to changes in the ILEC investment patterns related to year-over-year extraordinary capital costs or acquisition-related activity.

One very straightforward step to control costs, among others which will be discussed, would be to eliminate any kind of portability to CETCs not directly associated with loop costs. More fundamentally, monies that are provided to support actual costs incurred in ILEC networks (without any expansion in the ILEC's margins), are also resulting in an expansion in CETC payments without any verifiable investment, and potentially without any CETC investment occurring. In short, clarity is required concerning whether, how, and for what purposes wireless and other potential CETCs should be funded.

A side-by-side comparison of ILEC and CETC funding and growth in funding helps illustrate this point, as found in Table 3. The shaded data in the table highlight that, after excluding the approximate levels of access-to-USF transfers, funding of wireline providers is virtually flat over the last several years, while the fifth column indicates that growth in funding to CETCs is rising sharply. (There was a one-time increase in ILEC receipts in 2000 to adjust for a previous freeze in high cost loop funding, making the 17% increase less representative.) We suggest that targeted reform will solve the current "growth problem" by focusing on the new CETC program, which is currently without

[17] Similarly, Local Switching Support ("LSS") is intended to provide support for lack of economies of scale for rural carriers' switching costs (fewer than 50,000 lines), not to support regional switches for large wireless carriers. *See* 47 C.F.R. 54.301. 3Q2005 LSS annualized for CETCs was $85.3 million.

clear goals, without requirements, and without monitoring systems to ensure appropriate use of funding. The systems for wireline carriers are clear and well-developed. The same should apply to other USF recipients.

Table 3: Growth in ILEC and CETC Funding[18]

	Funding in $millions			% of USF		Growth in funding			
	CETC	**ILEC**	**Total**	**CETC**	**ILEC**	**CETC**	**ILEC**	**ILEC w/o (2)**	**Incremental ILEC funding (2)**
1998	.	1,696.6	1,696.6	0%	100%	-	-		
1999	.5	1,723.1	1,723.7	0%	100%	-	1.6%	**1.6%**	
2000	1.5	2,515.3	2,516.8	0%	100%	179.1%	46.0%	**17.0%**	$500M from reg. chngs., including IAS
2001	20.2	2,583.2	2,603.4	1%	99%	1251.1%	2.7%	**2.7%**	
2002	47.5	2,934.5	2,982.	2%	98%	135.3%	13.6%	**5.5%**	$210M from reg. chngs., including ICLS
2003	131.5	3,141.8	3,273.2	4%	96%	176.8%	7.1%	**2.6%**	$130M from reg. chngs., including ICLS/IAS
2004	333.1	3,154.5	3,487.7	10%	90%	153.4%	0.4%	**0.4%**	
2005E	719.4	3,174.2	3,893.5	18%	82%	115.9%	0.6%	**0.6%**	

Source: USAC; projections by Balhoff & Rowe and are based on USAC's 2Q05 estimates for full year

Table 4 provides a snapshot of current conditions that is even more detailed and compelling. The table highlights the USF payments in the fourth quarter of 2005 versus the payments in the final period of 2004, segregating the carriers into rurals and non-rurals, price-cap and rate-of-return, CETCs receiving payments and the total CETCs receiving payments plus those pending. The table highlights that the only ILECs receiving more monies in 2005 are the rural rate-of-return carriers. And gray-shaded statistics are particularly strong, indicating that the USF growth is a mere 1.0 percent for those carriers, *while all the other ILECs are actually posting lower year-over-year receipts, led by the rural price-cap carriers whose funding is* down *15 percent in 2005.* The data tell a story that is diametrically opposed to the popular view and possibly just as sharply opposed to public policy goals.

[18] This chart was prepared based on 2Q05 figures, and the normalizations for incremental funding are approximate.

Table 4: Quarterly Support Comparison, Rural, Non-rural, CETC Actual, CETC Pending

High Cost Support 4Q2005			Growth	
Non-Rural	ILEC	CETC	ILEC	CETC
ILEC-Price	$ 159,234,972.42		-3.5%	
ILEC-ROR	$ 19,455,381.42		-3.0%	
CETC		$ 53,901,540.00		149.2%
CETC-Pending		$ 16,131,884.00		236.5%
Total	**$ 178,690,353.84**	**$ 70,033,424.00**	**-3.5%**	**165.0%**
Rural	ILEC	CETC		
ILEC-Price	$ 70,813,754.00		-15.1%	
ILEC-ROR	$ 554,826,079.00		1.0%	
CETC		$ 111,929,079.00		63.0%
CETC-Pending		$ 22,076,367.00		-40.2%
Total	**$ 625,639,833.00**	**$ 134,005,446.00**	**-1.1%**	**26.9%**
Non-Rural + Rural	**$ 804,330,186.84**	**$ 204,038,870.00**	**-1.6%**	**54.5%**

High Cost Support 4Q2004		
Non-Rural	ILEC	CETC
ILEC-Price	$ 165,037,609.38	
ILEC-ROR	$ 20,067,039.00	
CETC		$ 21,628,698.00
CETC-Pending		$ 4,794,358.00
Total	**$ 185,104,648.38**	**$ 26,423,056.00**
Rural	ILEC	CETC
ILEC-Price	$ 83,440,604.00	
ILEC-ROR	$ 549,132,892.00	
CETC		$ 68,671,399.00
CETC-Pending		$ 36,935,189.00
Total	**$ 632,573,496.00**	**$ 105,606,588.00**
Non-Rural + Rural	**$ 817,678,144.38**	**$ 132,029,644.00**

Source: USAC 4Q05.

Recommendation: *Reform should be based on a correct identification of cost drivers, and should seek to reconcile support with costs*.

VI. THE LONG-TERM FOCUS OF THE HIGH COST FUND SHOULD BE SUPPORTING HIGH QUALITY NETWORKS CAPABLE OF PROVIDING ACCESS TO A VARIETY OF SERVICES, INCLUDING ADVANCED SERVICES.

The Rural Task Force's "no barriers to advanced services" recommendation included the following principles:

a) Universal service funding should support plant that can, either as built or with the addition of plant elements, when available, provide access to advanced services. State commissions could facilitate this infrastructure evolution and may make an exception for carriers with functional but non-complying facilities;

b) Telecommunications carriers should be encouraged by regulatory measures to remove infrastructure barriers relating to access to advanced services; and

c) The federal universal service support fund should be sized so that it presents no barriers to investment in plant needed to provide access to advanced services. Specifically, to remain "sufficient" under the 1996 Act, the fund should be sized so that investment in rural infrastructure will be permitted to grow.[19]

The FCC and the Joint Board have regularly affirmed their allegiance to "no barriers," including in the Rural Task Force Order[20]. Too often, this has taken the form of assuring that policies adopted were not inconsistent with "no barriers." Instead, the Joint Board and the Commission should identify ways to advance "no barriers initiatives," consistent with both Section 254 and Section 706. Indeed, implementation of universal service policies should be done mindful of the directives of Section 706 which require both the federal and state commissions to encourage the deployment of "advanced telecommunication capability to all Americans."[21]

VII. INVESTMENT IS INCREASINGLY DIFFICULT IN RURAL NETWORKS, WITH POLICY CONFUSION A SIGNIFICANT CONTRIBUTOR TO INVESTOR UNCERTAINTY.

The need to invest in and maintain high quality rural networks is occurring at a time of acute uncertainty for all carriers serving rural areas (large and small, investor-owned,

[19] *See Rural Task Force Recommendation* at pp.21-22.
[20] *In the Matter of Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Access Service of Non Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Dockets No. 96-45 and 00-256, 16 FCCR 11,244 (released May 23, 2001) ("*RTF Order*" or "*Rural Task Force Order*") at 11250-51.
[21] 47 U.S.C. 157nt.

privately-held and cooperative). The largest carriers face resource allocation questions and the need to respond to sometimes targeted competitive threats, making internal subsidy less tenable than ever. Network-wide, ILEC line counts are declining at rates between four and five percent per year.[22]

While small and medium-sized carriers have specialized in providing excellent service to rural areas, they are beginning to experience some of the same conditions faced by large companies, including declining second lines (in part due to their deployment of DSL), declining access revenue (even as terminating access minutes are increasing), disruption of vertical service revenue (again enabled by their own advanced services deployment), and targeted competition by carriers unencumbered by carrier of last resort obligations.

Policy-related risks are even more acute for small and medium-sized rural carriers, as they are more dependent on the system of network supports that have been developed over many years. As described above, national and state policymakers have aggressively accelerated that dependency, making the movement away from implicit support through access to explicit support through universal service a cornerstone of telecommunications policy. At the very time investment is critical, investors perceive acute risk associated with policy. Investors are not willing to support long-term capital commitments in this environment.

Importantly, the rural-company valuations have been depressed by the risks in the sector, as public equity investors are now requiring dividend yields of 7% to 10%. While investors recognize the technology and competitive risks for rural carriers, those factors

[22] *See e.g.* Trends in Telephone Service, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission, Table 7.1 "U.S. Wireline Telephone Lines (released April 2005). *(http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend605.pdf)*

are relatively less important in rural regions than in more urban centers. The higher dividend yields therefore arguably reflect significant regulatory uncertainty related to USF and, to some extent, intercarrier reforms. The significance of this insight is that USF concerns, driven by CETC growth, are causing an investment paralysis which must sooner rather than later be resolved by the policymakers lest rural regions be damaged for the longer-term.

Notably, regulatory risk comes in at least two forms: harmful regulatory actions and regulatory delay and uncertainty. Each of these is discussed below.

Harmful regulatory actions. In what could be called "policy iatrogenisis," misdiagnosis of policy problems can lead to policy prescriptions that harm or kill the patient. Unarguably, high cost support is increasing. However, many proposals that address fund growth are untethered from the source of growth portrayed in those recommendations and they fail to recognize the driving role of past policy decisions (universal service replacing access charges, identical and poorly disciplined support for CETCs) in causing this growth. Proposals to decouple support from investment (various freezes), to make support less explicit (study areas consolidation), or less predictable (block grants or the SAM Plan) risk maiming the patient, and should be rejected.

Regulatory delay and uncertainty. For multiple reasons, achievable reforms have been deferred, sometimes while interesting but unlikely approaches are pursued. Timely and implementable Joint Board recommendations will be an important contributor to reducing this source of uncertainty. Working with his colleagues, Chairman Martin has demonstrated that the FCC can reach a level of consensus that benefits the industry, can make timely decisions, and can take tough but realistic action. Building on this success by identifying and taking achievable steps forward will do a tremendous amount for the sector generally, and to advance the goals of Section 254 specifically.

Recommendation: *Reforms should be based on correct problem identification, and should be timely.*

VIII. IF COMPETITIVE ETCS ARE TO BE SUPPORTED, THE CETC REGIME REQUIRES GREATER CLARITY OF PURPOSE, DISCIPLINE AND ACCOUNTABILITY.

There continues to be genuine debate about whether or not multiple carriers should be supported in any one area. It is beyond argument that the current CETC regime looks far different from what was being publicly discussed at the time of the first wireless CETC applications: handsets that were designed to function like landline units, with service targeted to areas where landline service was not available. No policy maker contemplated a program approaching one billion dollars, with 97 percent of CETC support received by wireless carriers. USAC appendix HC-18 displays the number of CETC lines reported for each wireline serving area. As examples of the unforeseen proliferation of CETCs, Telephone USA of Wisconsin has twelve CETCs currently eligible to receive support. Additionally, several Iowa ILEC study areas (some with fewer than 1000 wireline customers) have eight or more CETCs eligible to receive support.

Given the principle of "adoptability," and the reality of path dependency, it is unlikely that the wireless CETC program will be terminated. However, it should be possible to think clearly about the CETC regime in light of certain basic principles, including discipline, accountability, and value for customers. The overall amount of support to wireless CETCs, coupled with the amount of support to individual carriers indicates this element of high cost support should be the subject of as much scrutiny as is the small wireline company element.

Confusion around the issue of substitutability is evinced by the position taken by Dr. Lee Selwyn, who has appeared before the Joint Board on behalf of Western Wireless. He has argued elsewhere (in opposition to Qwest) that wireless service is not a competitive substitute for wireline service, due to different functionality, service quality, scope and pricing, and cost structure.[23] Dr. Selwyn specifically stated, "Any direct comparison of the pricing charged today by CMRS providers versus the wireline providers such as Qwest for their bundled offerings (including toll) are distorted by the *artificial cost advantages enjoyed by the CMRS providers*."[24]

Recently, the New York Public Service Commission staff issued a report describing Verizon's loss of three million access lines in New York (twenty-five percent of its access lines in that state) over a period of three years, and citing the presence of independent intermodal competition, including wireless and cable, as the basis for proposed dramatic reductions in retail regulation.[25]

The point here is not that one view or the other is correct. Indeed, we believe that the relationship is much more complex than is evinced by Dr. Selwyn's two-year-old testimony (and Dr. Selwyn's views may have evolved as well), and is accurately described by the New York PSC staff report. There is clearly massive wireless service

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[23] Direct Testimony of Lee Selwyn, Utah PSC Docket 03-649-49, filed September 29, 2003.
[24] Id. at p. 60, emphasis supplied.
[25] *Telecommunications in New York: Competition and Consumer Protection*, filed in Proceeding on Motion of the Commission to Examine Issues Related to Intermodal Competition in the Provision of Telecommunications Services, New York Public Service Commission, Case 05-C-0616 (September 21, 2005), p. 4. The report describes similar losses for Frontier Telephone, along with loss of minutes of use, access revenues and local service revenues.

substitution for long distance service and second lines, along with increasing amounts of wireless primary access substitution, especially among certain populations. Rather the point is that an enormous amount of money has been spent, unconnected to cost of deployment, on the unexamined assumptions.

Customers have expressed in the marketplace their desire for mobility and flat rate long distance service. However, neither mobility nor long distance is a covered service for purposes of Section 254. The point is that we should more directly focus on what purposes are achieved by supporting mobile wireless or other CETCs, and then ensure that money spent in fact advances those purposes.[26]

The FCC's *CETC Order*[27] is a significant step in the right direction, and may be having some effect. The FCC's order was not as strong as it could have been: It is only advisory to the states; does not appear to necessarily require CETCs to meet the full mandate of Section 214(e) by offering supported services "throughout the service area for which the designation is received"; it remains unclear how cumulative effects on fund growth of many discrete applications will be treated. NARUC and individual states have undertaken important work around implementation. However, not all states have clear authority under state law to implement the Commission's order. The Joint Board and NARUC should support state efforts to implement certification processes that are efficient, transparent, rigorous, reasonably predictable, fair, and have the confidence of stakeholders. Further, to the extent CETCs, including wireless carriers, are considered to

[26] Non-wireless carriers may have different characteristics and in some cases may tend to provide a more substitutable service. However, with the exception of facilities-based overbuilders it is probably too early to know how these services will develop or consumers will respond. Statistics show that the current CETC regime is overwhelmingly a wireless program.

[27] *See infra*, fn. 7.

be a competitive substitute for current ETCs, all should have to meet the same high standard. These standards should include:

(1) A commitment to serve an entire area by
    (a) Reaching a substantial deployment benchmark standard on day one;
    (b) Achieving 100% coverage throughout the designated geographic service area within a specified period of time;

(2) Meet technology-neutral state standards for carrier of last resort level of service;

(3) Offer a comparable local service package to customers;

(4) Demonstrate network can function in emergencies for a reasonable period of time;

(5) Meet comparable quality of service, customer service and consumer protection standards; and

(6) Be subject to consistent reporting requirements (state and federal reporting requirements should be reviewed for all carriers.)

Although an important step forward, the *CETC Order* does not by itself resolve the question whether we are supporting wireless as exclusively as a competitive substitute for wireline service, as a complement to the service, or both. A variety of approaches have been suggested to achieve clarity, discipline and consumer value in the CETC regime.

The proposal to create a separate mobile wireless component within the high cost fund deserves further consideration. It recognizes that mobile wireless service has specific attributes and is explicitly tied to infrastructure deployment. If the decision is made to encourage mobile wireless deployment in rural or insular areas that are not currently served, a proposal along these lines may have merit. Support would be tied to infrastructure, and standards could be crafted that target wireless concerns, including for example capacity, reliability, and extension of coverage. To-date, such proposals have not received significant interest or support.

Substantively, any CETC regime should advance a coherent set of public purposes. There should be a relationship between the program and investments and expenditures to provide high quality service. It should be consistent with the long-term stability and viability of universal service. Customers should receive value for the support provided. The FCC, with the advice of the Joint Board, must make decisions that will provide the policy coherence to achieve these goals.

It is not appropriate to defer these tough decisions to state commissions.[28] All types of carriers require greater consistency across state lines and greater direction from the national level than would be provided by deferring core policy questions about CETC support to over fifty jurisdictions, some of which have already concluded that they lack the relevant authority. A strong record has been built in Joint Board and Commission proceedings concerning CETC policy. Issues noticed in this referral provide a basis to move forward on several high value action items.

Recommendation: *The Commission, based on Joint Board recommendations, should clarify the purposes for CETC support, rather than delaying these decisions or deferring them to the states.*

Recommendation: *The Commission should take additional steps to ensure program discipline, accountability and customer value in the CETC program similar to that already present in the rural rate of return program.*

Recommendation: *The Joint Board and Commission should support efforts of NARUC and state commissions to implement meaningful ETC certifications and review.*

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[28] *See supra* for a discussion of why the SAM Plan should not be adopted.

IX. SUPPORT SHOULD BE BASED ON THE RECIPIENT'S OWN COSTS.

A. CETCs Should Receive Support Based on Their Own Costs.

The absence of discipline, including strong enforceable requirements, coupled with the identical support rule appears to have affected at least some wireless entry decisions. In the seven states summarized below, the average per month per line support for identified wireless CETCs was compared to the RLEC statewide average per line per month support. In all cases, the wireless CETCs were receiving greater support than the RLEC average. At the least, this raises the question, deserving close examination, whether the current regime encourages some carriers to follow the Willy Sutton approach to seeking certification (going where the money is).

Table 5: RLEC Versus CETC Support

(Per line per month, selected states)

State	RLEC	CETC	Variance	Comment
Arizona	$ 21.03	$ 25.07	$ (4.04)	Smith Bagley
Colorado	30.49	36.68	(6.19)	Average - NE, Colorado Cellular, & Western Wireless
Iowa	8.17	18.02 12.11	(9.85) (12.11)	Western Wireless Midwest Wireless
Oregon	16.34	34.10 18.09	(17.76) (18.09)	RCC Minnesota U.S. Cellular
South Dakota	28.93	34.05	(5.12)	Western Wireless
Wisconsin	8.56	16.76 9.64	(8.20) (9.64)	Midwest Wireless U.S. Cellular
Wyoming	43.35	45.34	(1.99)	Western Wireless

Source: 3Q05 USAC Quarterly Submission, Appendices HC01 and HC05.

There are significant costs associated with the current "identical support" regime, but there is no necessary relationship between support and investment or service. The logical flaw was demonstrated in a Western Wireless presentation to the Regional Oversight Committee (ROC) for Qwest, which stated that the Joint Board:

Must not establish [a] different methodology for different technologies. This would violate competitive and technological neutrality. And send the wrong signals and incentives to the markets.[29]

However, if the same methodology is applied to different technologies with different costs, the resulting costs will be different, not "identical.". Still it is notable that the "identical support rule" is a different methodology from either embedded or forward-looking cost-based support. The claim is made that basing support on the carrier's own cost would violate competitive neutrality and send the wrong signals to investors and

[29]*Competitive Universal Service*, Phoenix Arizona, March 14, 2005, p. 9. The presentation went on to argue not for an identical methodology, but for identical support.

markets. However, RLEC support is based on costs already incurred; while, absent effective standards, equity analysts treat wireless CETC support as practically pure margin.

Acknowledging the progress made through the Commission's ETC order, there still continues to be a significant mismatch between ILEC and wireless or other carrier duties. Most states impose "Carrier of Last Resort" (COLR) obligations on wireline carriers independent of any high cost fund support they may receive. While specific requirements vary from state to state, in general, wireline companies must build and maintain ubiquitous and very reliable networks. Wireless CETCs, on the other hand, usually only build networks to serve high value customers or areas, and provide something closer to a "best efforts" level of service. Wireline carriers are subject to detailed customer service and service quality requirements; other carriers are subject to none. Wireline carriers are generally required to provide unlimited local calling, and are subject to various other retail and wholesale requirements, have extensively deployed E911, and provide backup power. It remains to be seen how far implementation of the Commission's *ETC Order* will go in reducing some of these differences, but ultimately fundamental differences between the regulatory regimes are likely to remain. And these difference will have significant effects on cost.

B. Basing Support On a Company's Own Costs Generally Meets The Act's Objectives Of Sufficiency And Predictability, And Is Directly Tied To Investment And Expenditures By The Recipient.

A company's "own costs" may be determined either on the basis of actual, incurred embedded costs, or on the basis of a working, verified economic model. For rate-of-return carriers, most of which are small, an embedded cost approach works very well.

Generally, embedded costs are consistent with core principles of Section 254, including specific and sufficient support (Section 254(b)(5)), reasonable comparability of service and rates (Section 254(b)(3)), and promotion of access to advanced services (Section 254(b)(2)). The reasonable predictability of documented cost recovery allows rural rate of return carriers to invest in networks, and facilitates deployment of advanced services over those networks. Embedded costs are also especially amenable to auditing, as support is based on investment already made.

Rural Task Force White Paper 2, *The Rural Difference*, described key differences between rural and non rural carriers[30]. The facts described are well known to the Joint Board, and have not changed since the preparation of that document. The Rural Task Force's White Paper, *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, compared model cost model results with actual results for 218 rural carriers, concluding that the results were widely disbursed.[31] As a result, the RTF recommended that embedded costs continue to be used for these rural (largely rate of return) carriers, stating that an embedded method

> inherently provides incentives for the infrastructure investment necessary for providing access to advanced services . . . . (T)o remain 'sufficient' the fund should be sized so that investment in rural infrastructure will be permitted to grow.[32]

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[30]*http://www.wutc.wa.gov/rtf/rtfpub.nsf/43e458610b70dda8882567d00074c6cd/4951d0c8d59b2d4d8825687000826423!OpenDocument*
[31]http://www.wutc.wa.gov/rtf/rtfpub.nsf/43e458610b70dda8882567d00074c6cd/7e7e6b591c8b6bf38825696800730b2b!OpenDocument
[32] *RTF Recommendation* at 22.

When the FCC adopted the Hybrid Cost Proxy Model ("HCPM") in 1997[33], it decided to retain the embedded cost method for rural carriers until "sufficient validation that forward-looking support mechanisms for rural carriers produce results that are sufficient and predictable."[34] From then until now, flaws in the model have persisted, making it entirely unsuitable for rural rate-of-return carriers, and hindering provision of appropriate support to large non-rural carriers. Over this time there has been limited and sometimes no FCC staffing to maintain, update and correct the model, no systematic Joint Board attention to model operations, and limited industry attention.[35] Failure to adequately address model flaws is an ongoing disservice to customers of non-rural companies whose support is based on the model.

Certain carriers and their customers find themselves with one foot on shore and one on the ship, while the ship is pulling out to sea. Certain rural service providers have purchased price-capped properties that were hurt by severe underinvestment at the time of acquisition, have appropriately committed to rebuilding these networks, and as a result of a combination of policies (including the "parent trap" of 47 C.F.R. 54.305), received support that was markedly inadequate to support the refurbishing efforts. In these specific situations, the Joint Board should consider recommending that rural price cap carriers be permitted, at their option, to receive support based on forward-looking methods that adequately take into account the flaws identified by the RTF. Generally, this change in the discipline would require the development of company-specific

[33] *In the Matter of Federal-State Joint Board on Universal Service,* CC Docket 96-45, Report and Order (released May 8, 1997).
[34] *Id.* at para. 252.
[35] The "synthesis" came out of the interaction of the Hatfield model, supported by MCI and AT&T, and the Benchmark Cost Proxy Model, supported by US WEST, BellSouth, and Sprint. Relatively little industry attention appears devoted to these broad modeling exercises at the present time.

information concerning fill factors, depreciation based on appropriate financial records and switch discounts, recognizing building rather than leasing where more appropriate, and encouraging high quality network design (e.g. Carrier Serving Area loop design or better), reliability issues associated with replacing small switching offices with Digital Loop Carrier ("DLC") and the need for rural fiber rings. A company would not undertake such a showing lightly. However, coupled with other program changes, it would better ensure that rural price cap companies have the ability to invest in their networks and improve service to their customers. Further, the policymakers would better ensure the welfare of a broader swath of consumers, including those who are caught in regulatory "limbo."

Recommendation: *Support for all non-average schedule companies should be based on their own costs.*

Recommendation: *Support for CETCs specifically, should be based on their own costs and network characteristics, either embedded or forward looking.*

Recommendation: *Support for rural rate of return carriers should generally continue to be based on embedded costs, with specific modifications as described below.*

Recommendation: *The HCPM should be subject to thorough and open review, concerning inputs to the model, modeling assumptions and formulae.*

Recommendation: *Purchasers of rural price cap properties should be allowed to propose company-specific approaches consistent with their circumstances.*

X. RULES HINDERING INVESTMENT IN ACQUIRED EXCHANGES SHOULD BE ELIMINATED OR FURTHER MODIFIED IN ORDER TO ENABLE INVESTMENT IN NETWORK REHABILITATION, AND NOT TO PENALIZE OTHERWISE EFFICIENT TRANSACTIONS.

It is encouraging that the Joint Board, including in the noticed proposals, is reevaluating support for exchanges purchased by rural-focused small and medium-sized companies from large companies. The "Parent Trap" rules of 47 C.F.R. 54.305 currently limit a purchaser's support to that amount previously received by the seller. Acquired property often needs extensive investment, as the seller has in all likelihood reduced investment in the period at least in the period leading up to the sale.[36] The seller generally received support through the large company program, which as described below, is in many cases inadequate.

Typically, purchasing companies are "rural experts," whose businesses succeed through investing and providing higher levels of service, and hopefully generating higher revenues. Generally, they are not companies choosing between investments in rural and urban areas.[37] At the time of acquisition, the purchaser typically intends to increase the level of investment in the first years to rehabilitate the property, respond to customer expectations, and meet regulatory commitments that often accompany approval of the transaction.

The existing "safety valve"[38] mechanism generally provides insufficient support for the acquirer's investment. Safety valve support is limited to fifty percent of loop plant investment; it does not recognize the full investment, and funds only a portion of what is recognized. Total safety valve support is capped at five percent of the high cost loop

[36] This also points to the need for prompt federal and state regulatory action on proposed transfers, as service to customers may be harmed during prolonged uncertainty.

[37] The rules under which most rural carriers currently operate do not include the implicit cross subsidies between high and low cost areas.

[38] 47 C.F.R. 54.305(b) – (f).

fund (approximately $53 million). Because of program restrictions, expected 2005 payouts were only $6.292 million.[39] In a further irony, under the identical support scheme, roughly one-third of safety valve support goes to CETCs, even though they are highly unlikely to be the acquirers of incumbent properties, and, generally, no real change has occurred in their investment patterns.

The current policy is undoubtedly well-intended, but has several perverse effects, including:

> (1) Rational transactions, which would get rural properties in the hands of rural experts eager to serve them, are deterred;
>
> (2) There is little incentive to bring the acquired network up to acceptable standards;
>
> (3) The mechanisms are inconsistent with policy goals supporting rural deployment of advanced services; and
>
> (4) "Penalizing customers who reside in areas where prior exchange owners chose not to invest is surely not [the Congress's] intended result."[40]

Modifications implemented last winter[41] partially address the problem, but there remains much more to do. At a minimum, an acquirer should be eligible for support for actual investment made following an acquisition. Baseline cost-per-loop support could be the seller's cost at the time of acquisition. The purchaser could receive seventy-five percent of the difference between its average per-loop cost and the baseline in the first years after the acquisition. Comparable support could be provided for non-loop investment. The "parent trap" penalty could sunset a certain number of years after the transaction (e.g., five years), by which time any discipline on purchase price would likely have washed through the system.

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[39] USAC HC07, 3Q05.
[40] Iowa Tel Initial Comments, p. 9, filed in this docket. ???
[41] See 70 FR 40, March 2005, p. 10060.

Recommendation: *The Joint Board should recommend significant reform or abandonment of the parent trap rules to allow meaningful investment in acquired rural property.*

XI. RURAL CARRIERS' STUDY AREAS SHOULD NOT BE CONSOLIDATED.

Proposals to consolidate study areas, both those originally noticed in this referral and those suggested by the recently-noticed plans, would harm the rural-expert carriers that are doing precisely what Congress intended, providing excellent service to rural areas. When, for whatever reason, a small carrier concludes it must sell, the rural consolidators ensure that service levels will be maintained or improved upon, and efficiencies will be realized.

The high cost portion of Section 254 focuses on "regions," and "rural, insular and high cost areas." Combining study areas would make support less "explicit" under Section 254(e). Statewide averaging would reintroduce implicit subsidies at the state level, and would extend to the rural carriers one of the policy failures currently afflicting customers of large companies. The difference would be that most rural carriers would not even have the lowest cost urban areas with which to "average" their costs.

A probably unintended consequence could in fact be to discourage efforts to consolidate some rural properties and could even lead to further fragmentation. Further, statewide averaging across study areas could in some cases (depending on state regulatory policy) drive changes in state rates to reflect changes in support, potentially undercutting "reasonable comparability" of support, and triggering costs and administrative burdens for state commissions and parties. More broadly, it could drive down capital investment, harming reasonable comparability of service and access to advanced services.

Regardless of ownership, high cost markets will still remain costly to serve, regardless of the structure of the serving firm. Depending on the specific circumstance, there are likely higher costs of installing and maintaining loop plant, challenging terrains, high switching costs in serving smaller numbers of lines, long transport operating costs, and service areas within a state typically separated by significant distances.

Most high cost loops are determined by service territory characteristics. In this regard, mid-size company service territories (which would be the subject of statewide consolidation) look like the service territories of smaller rural carriers. The plant remains expensive. They have little opportunity to benefit from scale. And they have low density service regions, with relatively few lines.

The economies that are created by a holding company structure are generally already captured where support is based on embedded costs. This is reflected in corporate operations expenses that generally fall well below the expense cap.

XII. THE LARGE COMPANY FUND MUST BE MEANINGFULLY REFORMED. POLICIES WHICH HAVE FAILED WHEN APPLIED TO LARGE CARRIERS SHOULD NOT BE IMPOSED ON RURAL CARRIERS.

This *Public Notice* is confined to the “rural” small company program. The four noticed proposals, however, do encompass modifications to the “non-rural” large company program as well. There are specific, actionable proposals the Commission can take to meaningfully reform the large company program. Such actions are required promptly in order to respond appropriately to judicial directives.

In 2001, the 10th Circuit Court of Appeals remanded the FCC's 9th Report and Order, concerning the non-rural fund, finding that the FCC had "not explained or supported its decisions adequately."[42] It specifically found insufficient support for using a 135 percent of national average benchmark.[43]

On remand, the FCC referred the matter to the Joint Board, which issued a recommendation that was largely adopted by the Commission, in an order issued in March 2003.[44] The Commission's order was again appealed to the 10th Circuit. In *Qwest II* , the court again rejected the Commission's order and, while declining to retain jurisdiction, remanded the matter back to the Commission for the second time. The court held that the Commission had relied on an erroneous and incomplete construction of Section 254 in crafting the support mechanism. The Commission's definition of "sufficient" failed to take into account the full range of Section 254 principles.[45] No deference was due to the Commission's definition of "reasonable comparability"; on remand, the Commission must define the term in a manner "that comports with its concurrent duties to preserve and advance universal service."[46] Further, the Commission must return with "empirical findings supporting its conclusion," and utilize its expertise to craft a support mechanism "taking into account all the factors that Congress identified."[47]

There are several lessons from this prolonged history and strong judicial directive:

[42] *Qwest I,* 258 F.3d at 1205. .
[43] *Qwest I*, 258 F.3d at 1202.
[44] *In the Matter of Federal-State Joint Board On Universal Service,* Order on Remand, Further Notice of Proposed Rulemaking, Memorandum Opinion and Order, CC Docket 96-45 (released Oct. 23, 2003).
[45] *Qwest II*, 398 F.3d at 1233-34.
[46] *Qwest II,* 398 F.3d at 1237
[47] *Id.*

(1) The Commission's failure over a period of many years to adopt a legally defensible program is a disservice to portions of rural America served by large companies;

(2) The court's holistic reading of Section 254 should inform Joint Board recommendations and Commission decision's concerning both the large company and small company funds;

(3) Given the track record, the Commission should refrain from simply "building a record," attempting to support the actions already taken. Rather, the Commission should undertake prompt and meaningful reform of the large company program; and

(4) It would be irresponsible to visit the failed policies of the large company program (e.g. statewide averaging) on smaller carriers.

Meaningful reforms regarding these issues are available. They include:

(1) Moving from statewide averaging to more targeted support;[48]

(2) Using a benchmark consistent with the Act's call for reasonably comparable rural and urban rates and service; and

(3) Developing and maintaining a costing methodology appropriate for large companies, serving diverse regions, and generally under price cap regulation.

Recommendation: *The "non-rural" large company fund should undergo prompt and meaningful reform, ensuring that support is sufficient to facilitate reasonable comparability of rates and services for rural areas served by large companies.*

[48] The New York PSC staff report, supra note 25, p. 43, describes the "legacy regulatory regime that borrowed higher revenue from more lucrative markets to keep rates lower than they would be," and explains that this is not sustainable in a competitive market.

XIII. POLICIES IN THE EXISTING PROGRAM SHOULD BE REFORMED TO ENSURE THAT THE GAP BETWEEN COSTS AND SUPPORT DOES NOT CONTINUE TO GROW.

The high cost loop fund cap reduces the proportion of recoverable costs. The amount of unrecovered costs is now $465 million. The cap is set based on the rural growth factor, which is determined by line growth and inflation. The factor did not anticipate negative line growth, which drives support further away from actual costs. Due to the high fixed-cost nature of the network, line loss does not generate an equivalent drop in costs. Among other modifications to ensure that support better follows costs, the Joint Board should consider modifications suggested by various parties to the caps and modification of the rural growth factor to account for the effects of line loss.

Table 6: Uncapped Versus Capped Support

($s in millions)	2003	2004	2005
Capped Support (Actual)	$ 1,045	$ 1,057	$ 1,056
Uncapped Support (Calculated)	1,243	1,360	1,522
Implied Shortfall	**$ (199)**	**$ (303)**	**$ (465)**
CAGR			***-53.1%***

Source: Based on annual FCC filings.

Table 7: Rural Growth Factor

Calcualtion of Rural Growth Factor:	**2002**	**2003**	**2004**	**2005 YTD**
Annual GDP-CPI % Growth	2.27%	2.37%	1.13%	1.83%
Annual Loop % Growth	3.26%	-0.10%	1.53%	-1.87%
Rural Growth Factor	**5.53%**	**2.27%**	**2.66%**	**-0.04%**

Source: NECA.

Recommendation: *The Joint Board should consider modifications to the formulae to ensure that support better follows costs.*

XIV. A CAP OR "FREEZE" AS PROPOSED SHOULD NOT BE ADOPTED.

These comments have already exhaustively established that high cost fund support increases are not driven by increased payments to rural ILECs, and some high cost fund program elements appear to be funded at too low a level. Both the President and Chairman Martin have forcefully declared their commitment to broadband deployment.[49] Infrastructure is costly, particularly infrastructure capable of supporting broadband services. Any cap or freeze as proposed would exacerbate the gap between costs and support, and further decouple support from network investment.

Proposals to freeze ILEC support at the time of competitive entry are especially problematic given the greater tendency of rural customers not to abandon their wireline phone, instead using their wireless phone as a complement. As suggested in these comments, greater thought and clarity is required concerning the CETC project. Concerns about fund growth are best addressed through clarifying the purposes of high cost fund support, and imposing greater discipline and accountability on the CETC regime.

Recommendation: *The high cost fund should not be capped or frozen, as variously suggested.*

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[49] See, e.g., http://www.whitehouse.gov/infocus/technology, and Comments of Chairman Kevin J. Martin at NARUC's Summer Meetings, Austin, TX, July 26, 2005 (http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-260312A1.pdf).

XV. HIGH COST FUND SUPPORT SHOULD NOT BE BLOCK-GRANTED OR AWARDED THROUGH THE SAM PLAN.

No job is messier than referee at a food fight. Moving away from the present formula-based system and passing off the allocation decision to state regulators would leave meatballs and marinara sauce on the faces of regulators from Augusta to Sacramento.

The food fight would be made worse (rocks in the meatballs) by any attempt to combine the small company program with the inadequate and still unreformed large company program. And the process would be made worse still (bricks in the meatballs) by artificially capping an inadequate combined program at previous years' levels, further decoupling support from costs for all carriers.

High Cost Fund support should be formula and rules based, not adjudication-based or driven by discrete applications. Indeed, the advantages of formula-based allocations, together with the Commission's responsibilities for effective and efficient fund management, are noted in the current *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*.[50] Formula based support is vastly more predictable than either block granting or the SAM Plan it is more likely to be sufficient,

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[50] Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, WC Docket No. 05-195 (Released June 145, 2005). In his Statement, Chairman Martin observed:

> Managing the USF in an efficient, effective manner is one of the Commission's core functions.
> . . .
> . . . In [the High Cost and Low Income] programs, the Commission's rules specify formulae that are used to distribute universal service support. This type of formulaic approach may hold promise for improving the administration of the E-Rate and Rural Healthcare programs.

These comments do not take a position concerning other elements of universal service. They do strongly concur that a formula-based approach has proven an efficient and effective approach to high cost fund allocation.

and it will achieve greater consistency across state lines, as required for carriers (ETCs and CETCs alike) pursuing multi-state deployment plans.

Rather than adjudicating the amount of support, the formulae applied are the proper subject of rulemaking proceedings. The deficiencies in universal service policy will not be addressed by punting those decisions to states. Rather, as explained earlier in these comments, national policy resolution is urgently required.

The nation has long experience with block grants or equivalent programs. They are clearly useful for some purposes, especially where they are designed to facilitate state rather than private sector activity.[51] Block grants, however, are especially vulnerable to political and budgetary uncertainty, and generally costly to administer compared with the current formula-based approach. In practice, the SAM Plan would be subject to the same reality which would directly threaten sufficiency or predictability for all high cost fund recipients and thus violate Section 254.

State Commissions possess many strengths. They are generally close to customers, benefit from local market and political knowledge, and are especially good at running contested case proceedings. As long recognized by NARUC, most recently in its white paper on Federalism and Telecom, it is necessary to employ a "pragmatic analysis that looks to the core competencies" of the state and federal regulators.[52] NARUC has embraced a "functional approach" to federalism. Concerning universal service, the NARUC white paper endorses a broad assessment base, a strong state role in certifying ETCs and CETCs, and the ability of states to operate independent funds. The SAM Plan

[51] Block grants in human services and elsewhere are criticized for under-funding of program objectives, lack of uniformity, and insufficient accountability. They are favored for empowering states and providing flexibility. Brookings Institution, *Forum, Block Grants: Past, Present, and Possibilities*, October 15, 2003, http://www.brookings.edu/comm/events/20031015.htm.

[52] NARUC White Paper on Federalism and Telecom, p. 2.

does not appear to be required by the NARUC policy, and does not appear to be consistent with an emphasis on core competencies or the functioning of states within a consistent national policy framework.

Direct administration of the fund by state commissions was considered and rejected by the Joint Board in its first Recommended Decision following passage of the Act.[53] Questions were raised both about resources and about uniformity across states. The Joint Board recommended:

> that the Commission support a universal service advisory board to designate a neutral, third party administrator. Administration by a central administrator, as opposed to individual state PUCs, would be more efficient, and would ensure uniform decisions and rules.[54]

This recommendation was effectively acted on by creation of the Universal Service Administration Corporation ("USAC") which is responsible to a Board of Directors made-up of a diverse group of industry personnel.

In its *Second Recommended Decision*[55], the Joint Board stated the following:

> (W)e cannot recommend that the Commission adopt that mechanism, in light of the long-standing practice at the time that the 1996 Act became law of distributing federal universal service support to the carriers providing the supported services, and the absence of any evidence in the statute or legislative history that Congress intended such a fundamental shift to a state block grant distribution mechanism. In addition, distributing funding directly to state commissions is likely to create substantial administrative burdens for states currently lacking this ability . . . ."[56]

[53] *In the Matter of Federal State Joint Board On Universal Service*, Recommended Decision, CC Docket 96-45 (released Nov. 8, 1996). ("*1st Joint Board Recommendation*").
[54] *1st Joint Board Recommendation* at para. 829.
[55] *In the Matter of Federal-State Joint Board on Universal Service*, Recommended Decision, CC Docket 96-45 (released Nov. 25, 1998) (*"Second Recommended Decision").*
[56] *Second Recommended Decision* at para. 61.

The FCC has also considered block granting as to interim hold harmless support in the non-rural program, and the schools and libraries program.[57] Block granting of universal service support has consistently been rejected, for good reasons.

As currently conceived, the SAM would not reassign collection and disbursement to the states. The distinction does not resolve fundamental flaws in the approach. It would continue to be less efficient than rules-based allocation, would require the inefficiency of multiple state proceedings, with federal backstop for those states that lack authority and a federal framework and review for those states that do undertake the effort. It would not achieve the uniform decisions considered desirable by the Joint Board. Indeed, uniformity would seem at odds with the justification for the SAM. Under Section 254 (a)(2) and (d) interstate universal service is the FCC's responsibility. There is no authority to delegate this duty to states.[58]

In recent comments in the Intercarrier Compensation Proceeding, the Montana PSC, which has a long history of engagement in universal service matters, stated the following: "(T)he MPSC does not have sufficient resources to manage and use FLEC models as used with the current high cost model mechanism. Nor are we able to duplicate the FCC's oversight of existing rural high cost mechanisms. The FCC should, however, continue to manage and improve its high cost modeling effort."[59]

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[57] Concerning interim hold harmless support, s*ee* Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 14 FCC Rcd 20,432, 20.474 (1999), *reversed and remanded on other grounds*, *Qwest v. FCC*, 258 F.3d 1191 (2001). Concerning the schools and libraries program, s*ee*, Recommended Decision, *Federal-State Joint Board on Universal* Service, CC Docket No. 96-45, 12 FCC Rcd 87, 153-53, 164 (1996); Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 12 FCC Rcd 8776, 9065 (1997).
[58] See *United States Telephone Assn. v. FCC*, 359 F3d 554, (D.C. Cir 2004) prohibited sub-delegation of FCC decision-making concerning availability of unbundled loops under Section 251(d)(2) to states or other entities. The same logic applies to the division of state and federal responsibilities under Section 254.
[59] *In the matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Reply Comments of the Montana Public Service Commission, p. 10 (filed July 20, 2005).

The block grant and the SAM Plan provide good thought exercises, and as such are useful. As policy recommendations, they fail the tests of adoptability and achievability with which these comments began.

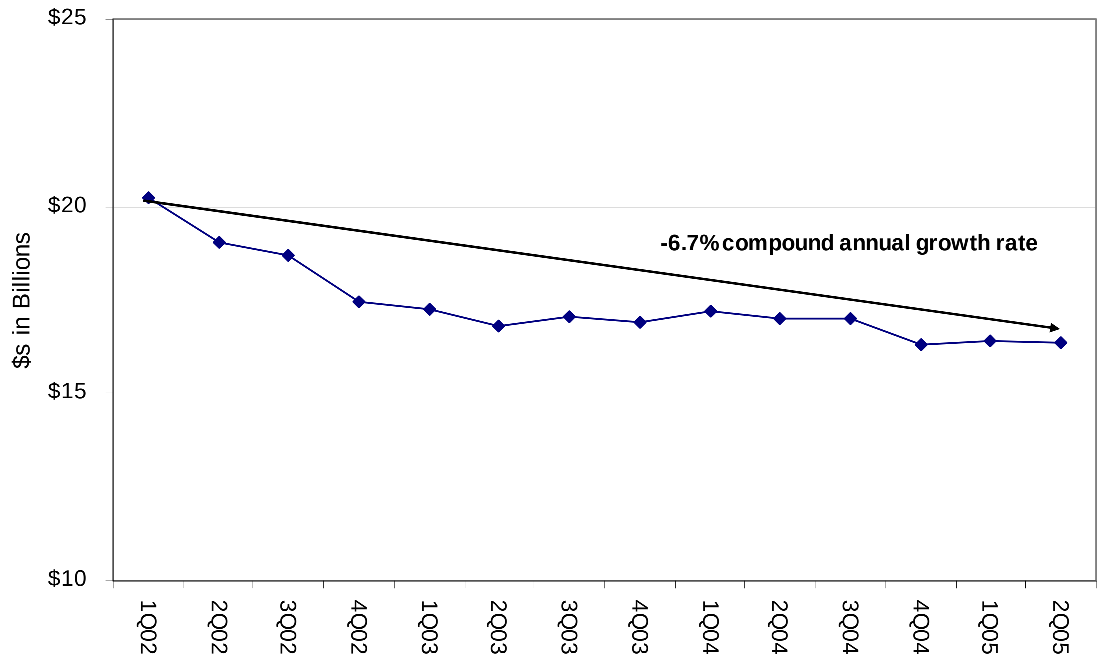
Recommendation: *Support should continue to be based on national rules and formulae. Key issues should be resolved by the Commission. States continue to have an important role in ETC and CETC certifications, through the Joint Board process, and in through direct participation in FCC proceedings.*

XVI. ALTHOUGH OUTSIDE THE SCOPE OF THIS REFERRAL, CONTRIBUTIONS REFORM IS CRITICAL, AND IS ALREADY A HIGH PRIORITY FOR THE COMMISSION.

Reform of the contribution base is a long standing priority. Although not part of this Referral, the noticed proposals correctly identify contributions reform as a key element of universal reform. Much has changed in the telecommunications market and in the marketplace of policy ideas since the Joint Board held an en banc hearing concerning contributions, and filed comments in the FCC proceeding.

As all know, the contribution base has shrunk and the traditional assessment base has become less sustainable, due to a combination of factors including declining IXC traffic, wireless substitution for long distance, the advent bundling, and going forward, increased IP-based traffic, as illustrated in Figure 5. Notably, none of these factors obviate the need for a robust network. Indeed, several make the need for advanced networks more pressing.

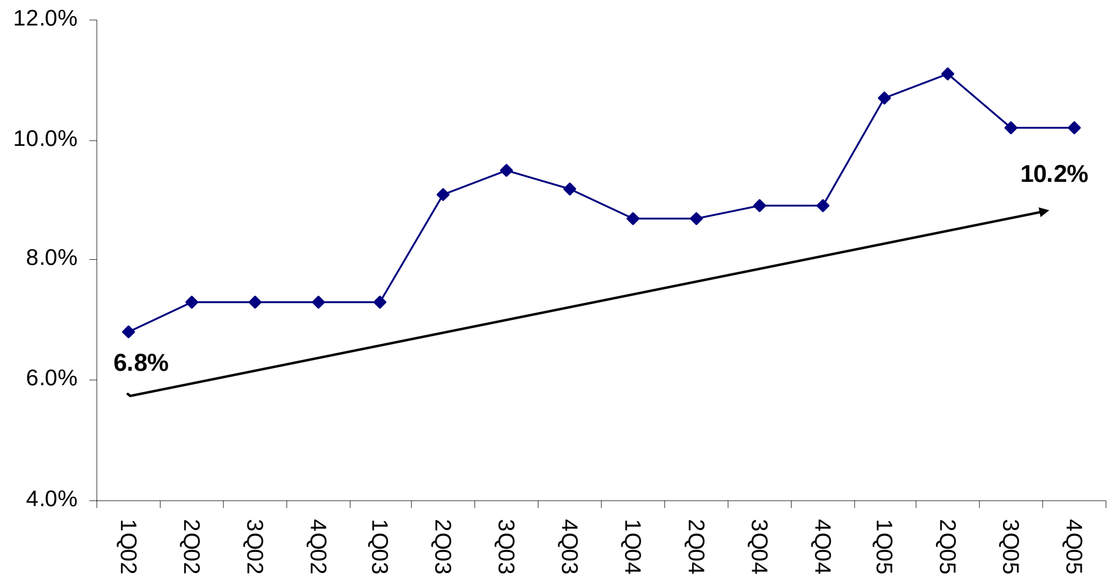
Figure 5: Shrinking USF Contribution Base



Source: FCC.

At the same time the base has shrunk, demands on the fund have increased, primarily due to shifting old access-related costs onto the fund and new support for CETCs. As a result, the contribution factor has edged up, despite several inter-program allocations in recent years. This trend will accelerate when DSL is reclassified (for most carriers) as a Title I service, making contribution reform all the more critical.

Figure 6: Increasing Assessment Factor



Source: FCC.

Congress, especially through the Universal Service Summits convened by Senators Burns and Dorgan, and through current legislative initiatives has expressed its strong concern with the contribution base. There are likely multiple ways to provide a stable foundation including broadening the base to capture revenue from new sources, deepening the base to include intrastate revenue (which would require Congressional action), basing support on connections, numbers and number equivalents, capacity-based charges, or some combination. There are two basic requirements:

1. **Reform is required promptly.** The Chairman's strong commitment to advancing contribution reform in a timely way is commendable, encouraging, and essential.

2. **Reform should be consistent with certain principles.** The following principles provide a reasonable guide for reform:

    a. The funding base should be as broad as possible to allow a lower assessment rate.

        i. A broad base and relatively low assessment rate will minimize incentives for uneconomic bypass and avoidance of the assessment, and will minimize any effect on consumption decisions.

    b. The funding base should be sufficient, stable, and predictable over time in order to:

        i. Minimize carrier and customer confusion.

        ii. Provide a better environment for network investment decisions.

    c. The funding base should be as non-bypassable as feasible, ensuring that no class of carriers or providers would be substantially free from the obligation to contribute.

    d. The funding base should be as technology and market resilient as feasible.

    e. All types of telecommunications providers that use the telecommunications network should contribute to its support.

Recommendation: *The Joint Board should support efforts by the Chairman, the Commission, and Congress to broaden and stabilize the contribution base for universal service.*

XVII. CONCLUSION: MEANINGFUL REFORM IS ACHIEVABLE WITHIN THE EXISTING PROGRAM STRUCTURE.

Actionable reforms do exist. This *Public Notice* provides an opportunity to consider both the Joint Board members' and staff's thoughtful contributions as well as additional approaches. To summarize, these comments make the following recommendations.

1. The Joint Board should focus on reforms that are adoptable, achievable, sustainable, and take into account the point at which reforms are commencing.
2. The Joint Board should focus on supporting robust network platforms, capable of providing rural areas with "reasonably comparable" services as well as rates to those in urban areas.
3. The Joint Board should support prompt implementation of a reporting and enforcement regime as part of a comprehensive network-focused approach.
4. Reform should be based in a correct identification of cost drivers, and should seek to reconcile support with costs. The Commission, based on Joint Board recommendations, should clarify the purposes for CETC support, rather than delaying these decisions or deferring them to the states.
5. The Commission should take additional steps to ensure program discipline, accountability and customer value in the CETC program similar to that already present in the rural rate of return program.

6. The Joint Board and Commission should support efforts of NARUC and state commissions to implement meaningful ETC certifications and review.
7. Support for all non-average schedule companies should be based on their own costs.
8. Support for CETCs specifically should be based on their own costs and network characteristics, either embedded or forward looking.
9. Support for rural rate of return carriers should generally continue to be based on embedded costs, with specific modifications as described below.
10. The HCPM should be subject to thorough and open review, concerning inputs to the model, modeling assumptions and formulae.
11. Purchasers of rural price cap properties should be allowed to propose company-specific approaches consistent with their circumstances.
12. The Joint Board should recommend significant reform or abandonment of the parent trap rules to allow meaningful investment in acquired rural property
13. The "non-rural" large company fund should undergo prompt and meaningful reform, ensuring that support is sufficient to facilitate reasonably comparability of rates and services for rural areas served by large companies.
14. The Joint Board should consider modifications to the formulae to ensure that support better follows costs.
15. The high cost fund should not be capped or frozen, as variously suggested.

16. Support should continue to be based on national rules and formulae. Key issues should be resolved by the Commission. States continue to have an important role in ETC and CETC certifications, through the Joint Board process, and through direct participation in FCC proceedings.
17. The Joint Board should support efforts by the Chairman, the Commission, and Congress to broaden and stabilize the contribution base for universal service.

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