Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45

Comments of the ICORE Companies

The consulting firm of ICORE, Inc. (ICORE), on behalf of its many rural incumbent local exchange carrier (ILEC) clients,[1] offers these comments in the above-captioned proceeding. ICORE provides a variety of consulting, regulatory and network-related services to many of the nation's small, rural ILECs.

I. INTRODUCTION

The ILECs represented by ICORE will be directly and seriously affected by the issues raised in the Further Notice, i.e., proposals for incentive regulation, proposed changes to the "all or nothing rule," pricing flexibility for rate-of-return carriers, and merging the Long Term Support (LTS) mechanism into the new Interstate Common Line

[1] ILECs participating in this filing include: Citizens Telephone Company of Kecksburg, Mammoth, PA; Dunbarton Telephone Company, Inc., Dunbarton, NH; Hot Springs Telephone Company, Kalispell, MT; McClure Telephone Company, McClure, OH; Midstate Telephone Company, Stanley, ND; Northwest Iowa Telephone Company, Sergeant Bluff, IA; NTELOS Network, Inc., Waynesboro, VA; Palmerton Telephone Company, Palmerton, PA; Park Region Mutual Telephone Company, Underwood, MN; Prairie Grove Telephone Company, Prairie Grove, AR; Richmond Telephone Company, Richmond, MA; Summit Telephone Company, Fairbanks, AK; Van Horne Co-op Telephone Company, Van Horne, IA.

Support (ICLS) element. Proper resolution of these proposals will prove critical to the future viability of some of the nation's smallest, most rural ILECs.

These carriers have already been affected in extremely negative ways by the Rate-of-Return Access Charge Reform Order, wherein the Commission adopted some, and rejected others, of the Multi-Association Group's (MAG) Plan[2] proposals. While we are certain that the Commission did not intend its order to have such adverse consequences, many small, rural ILECs have nevertheless been put in serious jeopardy.

Thus, while we will direct our comments primarily to the proposals raised in the Further Notice, we nonetheless feel compelled to offer suggestions on how the Access Charge Reform Order itself might be made more fair and equitable for small, rate-of-return ILECs.

II. THE RATE-OF-RETURN ACCESS REFORM ORDER IS DEFICIENT IN FOUR MAJOR AREAS.

In adopting or rejecting certain MAG Plan proposals, the Commission has imposed undue hardship on small, rate-or-return ILECs and their customers. While unintended, these negative consequences are real. The Commission should therefore revisit the following four harmful areas of its order:

A. Denial of the MAG Proposal to Impose Requirements on IXCs Concerning Optional Calling Plans, Minimum Monthly Fees, and Pass Throughs of Access Charge Reductions.

[2] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Service for Local Exchange Carriers,* Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304 (rel. Nov. 8, 2001) (*Rate-of-Return Access Charge Reform Order and Further Notice).*

Rather than belaboring this issue with speculation and supposition, we need only point to what several IXCs have actually done. At roughly the same time as the Commission's access charge reducing order was implemented, the three largest IXCs actually raised their long distance rates.

AT&T, which attempted this same kind of action coincident with the earlier CALLS Order, substantially increased its basic rates for all long distance customers that do not subscribe to one of its toll plans. Beginning February 1, (one month after implementation of the major provisions of the access reform plan), AT&T's basic rate for weekday calls (7 a.m. to 7 p.m.) increased from 30 cents to 35 cents; weekday calls (7 p.m. to 7 a.m.) from 25 cents to 29.5 cents; and weekend calls from 16 cents to 18.5 cents.

Sprint also increased its basic rates, from 10 cents to 20 cents on Saturday, and its basic Dial-1 interstate service and international rates for customers not on a long distance plan by 10%. MCI has taken a different approach, but it is also raising rates at the same time as access charges are being reduced and SLCs increased. MCI will increase rates for some of its calling plans, including its "MCI 7¢ Anytime" plan, which will go from $3.95 to $4.95 per month.

The AT&T and Sprint basic per minute increases severely impact those toll users who don't make enough interstate long distance calls to justify subscription to a toll plan. With residential SLCs at $5.00, the AT&T non-toll plan customer that makes 10 minutes of weekday, daytime calls per month will now pay the equivalent of $8.50, or 85 cents per minute, for interstate toll service [$5.00 + (35 cents x 10)].

MCI's low volume users are also negatively affected. The "MCI 7¢ Anytime" subscriber that generates 20 minutes of interstate toll per month will experience a 5 cent per minute rate increase ($1.00 ÷ 20). He or she will now pay .5675 cents per minute for interstate toll service [$5.00 + $4.95 + (.07 cents x 20)].

Clearly, the adoption of an access reform plan for rate-of-return ILECs, absent corresponding constraints on IXCs, has not resulted in lower interstate toll rates, at least for the low volume users that most need such relief. Instead, these users have been punished by the combination of higher SLCs and higher basic toll rates.

IXCs have long pushed for reduced access charges, and they have been granted these reductions under both CALLS and the Commission's version of the MAG plan. It is time that the IXCs were made to uphold their end of the bargain - - if not voluntarily, then by regulatory requirements governing pass throughs, monthly flat fees, and optional calling plans as originally proposed in the MAG plan.

B. Flash-Cut of the Multi-Line Business SLC to $9.20 at January 1, 2002.

While increases in the residential and single-line business SLC are burdensome enough (and result in de facto toll rate hikes for end users), at least these increases are phased in over an eighteen month period. The flash-cut of the multi-line business SLC is even more onerous to the small business customers of small, rural ILECs.

Coming as it does all at once, the substantial increase to $9.20 produces real rate shock for the typical two or three line rural business. These businesses are not generally IBM, Microsoft or GE, but Inga's Busy Market, Mike Crowe's Soft Serve, or Gene's Engines. "Mom and Pop" operations rather than multi-national corporations, they typically exist on low margins and continually fight for their very survival.

A large SLC increase, particularly one not accompanied by corresponding interstate toll rate reductions, will force a small, rural business to do one of three things: absorb the cost, squeezing margins even tighter; pass the cost through to its customers, which may drive them to larger businesses located in more urban areas; or discontinue one or more lines, which is detrimental to the small business, its serving ILEC, and the economy in general.

The economy, in fact, is in recession; small (and in some cases large) business failures are occurring at an alarming rate; and unemployment is higher than it has been in several years. The imposition of significantly higher, non-discretionary per line charges on the nation's smallest, most fragile businesses couldn't come at a worse time.

If the Commission must raise multi-line business SLCs, it should do so in increments, similar to its treatment of residential and single-line business SLCs. This would at least soften the blow, allowing small businesses to adjust over time to the more gradual increases in their fixed, per line costs.

Combined with requirements (for the reasons outlined above) that IXCs reduce interstate toll rates even for low volume users - - residential <u>and</u> business - - the phase-in of the multi-line SLC would have a far less negative impact on small businesses than the prescribed flash-cut.

C. <u>Replacement of the CCL Rate with an Interstate Common Line Support Mechanism.</u>

The complete replacement of traditional per minute CCL charges with an Interstate Common Line Support (ICLS) mechanism is a large step in the wrong direction for small, rural ILECs. It moves one more identifiable and supportable rate element, and

the revenues derived therefrom, from the clear realm of access charges into the murky waters of universal service funding.

USF, at least for small ILECs, has always been a valid and necessary mechanism to recognize their higher costs in certain areas, and to assign a proportionately larger share of those costs to the interstate jurisdiction. Local rates have been kept affordable, and universal service has been preserved.

High cost loop support and local switching support have long been, and continue to be, successful programs to properly compensate the high costs of small ILECs through the interstate jurisdiction, rather than through unreasonably high local service rates. ICLS, however, is a horse of a completely different color.

CCL rates have decreased substantially through the years, primarily due to the imposition of increasingly higher SLCs. Now, the Commission would totally eliminate the remaining CCL charge in favor of the new ICLS. Unlike other USF mechanisms, ICLS is not designed to recover the higher-than-average costs of certain small ILECs, but the basic common line costs of <u>all</u> rate of return carriers.

The ICLS concept begins to stray dangerously from the intertwined regulatory paths of (1) recognizing the actual use to which the plant is put, and (2) assigning the cost to the cost causer. It is not difficult to imagine that this large step - - replacement of the tariffed per minute CCL rate with yet another USF element - - will lead to a smaller, but even more devastating, step: elimination of the ICLS in favor of yet another SLC increase.

But this is just uncomfortable speculation. The reality is that as a universal service support element, ICLS is extremely vulnerable. It is vulnerable to political attack, regulatory whim and IXC abuse.

IXCs, for instance, constantly lobby for changes which will reduce, or eliminate, USF support. They also abuse the process, collecting more from their customers than they are required to pay through quarterly USF contribution factors. The three major IXC's have been charging their customers 9.9% of interstate and international revenues to cover a contribution factor which, over the last four quarters, has required them to pay about 6.9% of interstate and international revenues into the combined USF programs.

This rather substantial mark-up would seem to adequately compensate them for any timing differences and administrative costs, which the IXCs continually use to justify such a differential. Recently, however, AT&T raised its "universal connectivity charge" to 11.5%, a staggering differential over the first quarter, 2002 USF contribution factor, which has actually declined slightly to just over 6.8%. Once more, an IXC raises its charges in the face of Commission-approved reductions in its costs.

Now come the new ICLS, which will increase substantially the total size of the universal service fund, making it an even bigger target for IXC attacks. It will also provide them the opportunity to further overcharge their customers, which they appear to be doing already, since the USF contribution factor will have to grow in order to accommodate the ICLS. IXC USF fees, which are presently 46% to 69% higher than the USF contribution factors which they are supposed to recover, [3] will have to increase

[3] Sprint and MCI will charge 9.9% to recover the first quarter, 2002 USF contribution factor of about 6.8%, which represents a 46% mark-up. AT&T's universal connectivity charge of 11.5% equates to a 69% differential.

proportionately - - or perhaps more than proportionately, if AT&T continues to have its way.

ILECs, unlike the IXCs, do not have the luxury of unilaterally increasing their USF revenues. In fact, past Commission actions have frozen the total fund; limited the amount of corporate operations expenses to be included in the fund's calculation; frozen or reduced funding in certain situations, particularly those associated with mergers and acquisitions; and rejected NECA proposed formulas which would have substantially increased high cost loop payments to small, average schedule companies.

There is also a great deal of uncertainty regarding universal service in the various intrastate jurisdictions. Some states, for instance, mirror interstate access charges. When interstate revenue requirements have been shifted from access to USF (as was the case several years ago with DEM weighting/local switching support), certain states have made only a part of the necessary adjustment. While mirroring the lower interstate access charges, they have failed to establish a comparable intrastate USF element to recover the resultant access revenue shortfalls.

ICLS may meet a similar fate. If states eliminate CCL charges without providing an ICLS-like USF mechanism, ILECs will experience severe intrastate revenue reductions. Rather than establishing a new support element, some states may take the easy way out - - prescribing higher SLCs or higher local service rates to recover the lost CCL access revenues. In either case, the ILEC end user suffers, costs are totally disconnected from the cost causer, and the IXCs are given a free ride on the ILEC's common line facilities.

Moving a per minute access charge to a universal service support element - - CCL to ICLS - - makes an even greater proportion of ILEC revenue vulnerable to the ever shifting tides of legislation, regulation and IXC action. CCL charges should thus be maintained as a viable access tariff element for the foreseeable future.

D. Methodology for Revising Traffic Sensitive (TS) Tariffs for Average Schedule Companies.

Many average schedule companies have elected, for a variety of reasons, to file their own TS tariffs pursuant to Section 61.39 of the Commission's rules. In accordance with these rules, such tariff filings are based on historic average schedule settlements and historic demand units.

The average schedule formulas themselves are based on certain data from a statistically chosen set of cost companies and average schedule companies. This nationwide, average data is statistically modeled to produce formulas that are thought to be representative of the costs of average schedule companies. Only in the calculation of monthly settlements, where a company's individual demand units are applied to the statistically-derived formulas, are company specific data ever used - - and then only for demand elements such as access lines and interstate toll minutes.

In shifting the costs of line ports from TS to CCL, as prescribed in the order, those average schedule companies filing their own TS tariffs were allowed to use an average cost factor furnished by NECA. That is, a nationwide, average percentage was used to estimate and transfer the line port costs. This comported perfectly with the development of the average schedule formulas, which underlie the average schedule companies' filed TS (local switching) rates.

The elimination and reallocation of the Transport Interconnection Charge (TIC) for these same average schedule companies, however, was accomplished in an entirely different manner. The Commission's rule called for the TIC to be reallocated to all access categories on the basis of projected revenue requirements, including special access, for each of those categories.

Not only does this rule fail to comply with Section 61.39, which prescribes the use of historic, rather than projected, cost and demand, but it flies in the face of the average schedule formula development process. Where the formulas, and the TS tariff rates derived therefrom, are based on average industry data and statistical modeling, the TIC reallocation uses company-specific revenue requirements.

This mismatch produces anomalous results, particularly in the area of special access. In many cases, the resultant rates are so high as to put the average schedule company at a distinct competitive disadvantage.[4] Neither the Commission's competitive initiatives, nor the Telecommunications Act of 1996, are well served by this situation.

These comments are not the place for an exhaustive analysis or discussion of a TIC reallocation methodology which better dovetails with the average schedule process. Very simply, a NECA factor - - similar to that provided for the shift of line port costs - - would produce a more representative set of special access rates.

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[4] A comparison of T-1 Rates, including a typical ICORE company in this filing, shows the following:

Carrier	CT	CMT	CMF	TOTAL
Typical CLEC	$176.90	$ 96.35	$19.25	$292.50
Verizon	$109.50	$101.00	$19.75	$230.25
ICORE Client Before TIC Reallocation	$160.10	$ 85.46	$17.33	$262.89
NECA Before TIC Reallocation	$176.82	$ 94.38	$19.14	$290.34
NECA After TIC Reallocation	$191.82	$102.39	$20.76	$314.97
ICORE Client After TIC Reallocation	$209.70	$111.93	$22.70	$344.33

Many average schedule companies filed their own TS tariffs so that their special access rates would be lower than NECA's, and in some instances, their competitors'. Now, the Commission's TIC reallocation methodology raises the average schedule companies' special access rates to the highest levels in the industry.

In short, average schedule companies that file their own TS tariffs should be afforded the opportunity to use a NECA supplied factor, rather than company-specific, projected revenue requirements, in reallocating the TIC.

III. THE COMMISSION SHOULD ADOPT THREE MAJOR PROPOSALS AS SET FORTH IN THE FURTHER NOTICE.

The original MAG plan included several proposals which the Commission chose not to adopt in its order, but rather to put out for additional comment through its Further Notice. As least three of these proposals should be adopted, for the following reasons:

A. The Optional Incentive Regulatory Regime.

A key feature of the industry-sponsored MAG plan is an optional incentive regime - - a Revenue Per Line (RPL) mechanism - - which ILECs could choose in lieu of traditional rate-of-return regulation. The Further Notice asks for comments on this, as well as alternative, incentive-type regulatory regimes.

For the sake of brevity, we will not repeat here the many persuasive arguments in favor of incentive regulation offered by the industry associations in the original MAG plan. It is enough to say that a totally optional RPL mechanism will benefit a number of ILECs, their customers, the IXCs and the Commission itself.

For those ILECs with fairly stable costs and reasonable access line growth rates, RPL will bring a welcome measure of predictability and stability to their budgeting and planning processes. These companies will be able to estimate their short and long term interstate access revenues with a great deal of certainty, allowing them to schedule infrastructure investments and to make maintenance and expense decisions in a rational manner. The ability to predict revenues with some precision will allow them to manage

and control their costs in a way that will benefit all of the various stakeholders in the telecommunications process.

Over time, this incentive to keep costs down - - RPL provides a stable, predictable revenue stream that is independent of an ILEC's costs - - will lead to savings for all of its customers. The ILECs' own end user customers will benefit, along with IXCs and others that use their networks, and competitors that lease their facilities.

In effect, RPL functions much like the Commission's Price Cap mechanism for larger ILECs. Revenues are limited on the settlement side, rather than through tariff rates, but the resultant incentive to operate efficiently and control costs is the same.

Optional RPL furthers many of the Commission's goals and objectives. It will in all probability move many of the larger rate-of-return ILECs to an incentive-based, price cap like mechanism. This will leave only a small fraction of the ILEC industry - - generally small ILECs with volatile cost structures, serving unique and diverse areas of rural America - - on a rate-of-return basis which much better fits their needs.

In fact, all of the major benefits which flow from price caps should be similarly realized under the optional RPL mechanism. RPL simply spares those ILECs electing it from the regulatory burdens imposed by costly, complex and comprehensive access tariff filings. While those companies most likely to choose RPL may be large by rate-of-return ILEC standards, they are only a fraction of the size of the Verizons of the world. Thus, RPL represents a very good compromise between rate-of-return and full price cap regulation.

But RPL <u>must</u> be optional. The very smallest, most rural ILECs - - many serving only a single exchange with three digit customer bases - - could not survive under RPL.

Their costs fluctuate too dramatically from year to year, their line growth is too unpredictable, and they are too subject to forces beyond their control.

A switch replacement or major outside plant project can significantly increase their investment base; a man-made or natural disaster - - wind, fire, snow, flood - - will raise their expenses by several orders of magnitude; a "cherry picking" competitor taking their one large business customer will cause a catastrophic loss of revenues - - and access lines.

The RPL mechanism will place these ILECs in the serious, if not critical, condition of under recovering their interstate access costs. With no interstate rate-of-return settlement mechanism to assist in that cost recovery, they will have little choice but to raise local service rates to cover what is essentially an interstate revenue shortfall. The cause of universal service will suffer, as these small ILECs are generally the <u>only</u> entities willing and able to serve the most rural areas of America.

Thus, where RPL may work for many of the larger, relatively stable rate-of-return ILECs, it will not work at all for those ILECs with volatile costs, sporadic line growth and acute sensitivity to external events.

For the very compelling reasons outlined above, the Commission should adopt the RPL regulatory regime as an option to traditional rate-of-return regulation.

B. <u>Elimination of the "All or Nothing Rule."</u>

The "all or nothing rule" mandates price cap regulation in a number of situations: when a rate-of-return carrier or study area converts to price caps, all of its affiliates or study areas (except those using average schedules) must do the same; when a price cap carrier is in a merger, acquisition, or similar transaction, it must continue to use price

caps after the transaction; and when rate-of-return and price cap carriers merge or acquire all or parts of one another, the rate-of-return carrier must convert to price caps within one year.

This last provision in particular imposes heavy, yet totally unnecessary, regulatory burdens on rate-of-return ILECs. It impedes the acquisition by these carriers of Price Cap carriers' rural exchanges, and substantially increases the regulatory costs associated with such transactions.

RBOCs have been eager to sell their rural properties in recent years, and smaller rate-of-return carriers have been willing, in most cases, to buy them. The public interest is well served by these acquisitions. The RBOCs are able to jettison what they feel are their least profitable exchanges, while the acquiring ILEC gets to do more of what it does best - - serve rural America. Generally, the rate-of-return carrier upgrades facilities and services in these rural exchanges, and its new customers are much better off than they were under RBOC ownership.

The "all or nothing rule," however, impedes these mutually beneficial transactions. Small rate-of-return carriers, which might otherwise be interested in joining the negotiation and bidding process for the proffered RBOC properties, are often intimidated by the specter of Price Cap regulation. Those that dare join the fray, and are successful, must petition the Commission for waiver of its "all or nothing rule" in order to avoid forced conversion to price caps.

While the Commission has generally granted such waivers, there is no absolute assurance that it will, in every instance. Rural ILECs acquiring Price Cap carriers' exchanges are put somewhat in the position of Damocles, with the sword of price cap

regulation hanging above their heads. Even when the Commission grants relief from its "all or nothing rule" - - the sword doesn't fall - - the rate-of-return carrier has to spend significant time and money to keep that sword suspended.

Rate-of-return ILECs buy rural RBOC exchanges to improve customer service, as well as to expand their operations and improve their bottom lines. They almost always have to expend considerable sums of money to upgrade switching and outside plant facilities. Rate-of return regulation simply helps them recover their substantial capital outlays.

Price caps would not only preclude them from properly recovering these necessary investments, but would force them to file complex access tariffs. Allowed to remain on a rate-of-return basis, these ILECs are able to avail themselves of NECA's tariff filing and revenue distribution functions, thus saving additional operating and regulatory costs.

Rate-of-return carriers do not gain unfair advantage or in any way "game the system" by acquiring price cap exchanges, and then converting them back to rate-of-return status. They simply recover their additional costs in an appropriate manner, and continue to use a tariff and settlement process which is most efficient for them.

The Commission should eliminate its "all or nothing rules," at least as they pertain to rate-of-return carriers engaged in mergers, acquisitions and related transactions. Accounting and other safeguards already in place should be sufficient to prevent any abuse of these situations.

C. Pricing Flexibility

Allowing rate-of-return ILECs the same measure of pricing flexibility as Price Cap carriers should be the Commission's easiest decision of all. Just as CALLS reformed access charges for ILECs under price caps, the instant order reforms access charges in a similar manner for rate-of-return carriers.

SLCs have been raised to the levels prescribed in the CALLS order, and access charges are trending lower, for rate-of-return carriers. In other words, they have their own CALLS-like plan. And while competition in rural America hasn't in all cases reached the same stage as it has for the non-rural, Price Cap carriers, many rate-of-return ILECs are nonetheless encountering a variety of tough competitors.

In all fairness, the Commission should grant rate-of-return carriers exactly the same pricing flexibility as their Price Cap counterparts. They have voluntarily submitted their access reform plan - - the MAG plan - - and the Commission has adopted many of its CALLS-type provisions. To grant them less than full parity with the Price Cap carriers in the area of pricing flexibility would border on discrimination.

For those rate-of-return ILECs facing stiff competition, pricing flexibility with respect to volume and term discounts, contract pricing, and geographic deaveraging within the study area, will allow them to compete on more even ground.

IV. CONCLUSION

ILECs remain the most heavily regulated entities in an increasingly competitive and deregulated industry. IXCs, CLECs, ISPs and others are free to act in ways that,

when undertaken by ILECs, are either totally prohibited or entail cumbersome regulatory burdens.

Adoption by the Commission of all recommendations included herein will still leave ILECs far more stringently regulated than any other segment of our industry. But the playing field will be leveled, at least a little, on behalf of the smaller ILECs. And many of the Commission's competition and deregulation initiatives will be advanced.

The Commission, from many standpoints - - including fundamental fairness - - should therefore adopt our recommendations.

Respectfully submitted,
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