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October 17, 1997

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

Re: Comments of TDS Telecommunications Corporation
on Non-Rural Cost Proxy Issues -- CC Docket No. 96-45

Dear Mr. Caton:

Transmitted herewith, on behalf of TDS Telecommunications Corporation, Inc., are an original and 9 copies of its comments on the Section III. C.5,7,8 & III. D platform issues and Section IV issues in the above-referenced proceeding.

In the event of any questions concerning this matter, please communicate with this office.

Very truly yours,

Margot Smiley Humphrey

Margot Smiley Humphrey

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
Forward-Looking Mechanism for High Cost Support for Non-Rural LECs	)	CC Docket NO. 97-160

COMMENTS OF TDS TELECOMMUNICATIONS CORPORATION ON III. C. 5,7, 8, III.D & IV PLATFORM ISSUES

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TABLE OF CONTENTS

General Observations and Framework for Proxy Cost Modeling of General Support Facilities, Expenses, Support Areas and a Local Usage Component 3

Issue One — III.C. 5, 7,8 & III.D Platform Issues 4

General Support Facilities — ¶¶ 142-148 4

Depreciation — ¶¶ 149-155 6

Expenses — ¶¶ 155-173 6

Customers Services — ¶¶ 166-168 10

Corporate Operations — ¶¶ 169-171 11

Support Areas — ¶¶ 174-176 12

Issue Two — Section IV 14

Support for Local Usage — ¶¶ 177-178 14

Conclusion 17

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

In the Matter of	)	
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Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Forward-Looking Mechanism for High Cost Support for Non-Rural LECs	)	CC Docket No. 97-160

COMMENTS OF TDS TELECOMMUNICATIONS CORPORATION ON III.C. 5,7,8, III.D & IV PLATFORM ISSUES

TDS Telecommunications Corporation (TDS or TDS Telecom), by its attorneys, submits these comments, divided into two parts. The comments deal, in a section labeled Issue One, with the Platform Issues raised in sections III.C.5,7,8 and III.D and, in a section labeled Issue Two, with the Local Usage Support issues raised in section IV of the Notice of Proposed Rulemaking[1] in the above-captioned proceeding. The purpose of the proceeding is to develop a forward-looking economic cost (FLEC) proxy model to use in calculating what high cost universal service — provided by non-rural local exchange carriers (LECs) designated as eligible

[1] Further Notice of Rulemaking (FNPRM), "Forward Looking Mechanism for High Cost Support for Non-Rural LECs," CC Docket Nos. 96-45 and 97-160 (released July 18, 1997).

telecommunications carriers (ETCs) — will receive federal support under §254 of the Telecommunications Act of 1996.[2]

TDS Telecom is commenting on behalf of its 105 incumbent LECs (ILECS) in 28 states. Although all of the TDS Telecom ILECs qualify as rural telephone companies under §3(47) of the Act,[3] and consequently are not directly affected by this phase of the Commission's FLEC-design plans, TDS is concerned that the Commission's intention is to extend a very similar — if not identical — proxy model to rural ILECs in the future cost methodology proceeding it plans for the ILECs not covered by this phase.[4] These comments seek to raise some of the many differences that set rural ILECs apart from the companies under consideration here and to emphasize the adverse consequences for rural customers and their universal service providers of applying a scheme developed for large, urban-centered companies to the markets served by rural ILECs.[5]

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[2] 47 U.S.C. § 254.

[3] 47 U.S.C. § 153 (47).

[4] For example, the Commission has instructed the Rural Task Force that will soon be named to examine the proxy model it is designing here to see if any changes are necesssary to apply it to rural ETCs. Public Notice, FCC 97 J-1, p.1 (released September 17, 1997).

[5] TDS Telecom has responded in these comments to two of the three sets of issues the NPRM identifies for comment with today as the deadline. The comments are set forth in two separate sections, Part One and Part Two, and the specific subject areas and sections of the NPRM are identified by headings. TDS Telecom is not filing comments on the III.B.3 and III.C inputs for a non-rural forward-looking cost (FLEC) proxy because it does not believe data about its primarily rural operations would be useful in modeling the costs of the large, non-rural companies that are the subject of this rulemaking. However, its responses here will necessarily cover some ground that might be regarded as relevant to inputs, owing to the critical importance TDS attaches to the ability of a model to incorporate individual company differences by using individual company data inputs.

General Observations and Frame work for Proxy Cost Modeling of General Support Facilities, Expenses, Support Areas and a Local Usage Component

The NPRM's discussion of platform assumptions raised in these sections of the NPRM provide several good examples of the inconsistencies, unjustified assumptions, internal conflicts and faulty conclusions that invalidate the proposed models and preclude the Commission's reliance on any proxy founded upon an imaginary optimally efficient network. The problems boil down to a fundamental conceptual flaw that undermines the whole approach: A model based on the economic fiction that the upper boundary for cost recovery in working competitive markets is the ever-changing cost of a new network, always incorporating the best new technology as it becomes available over time, cannot replicate or stimulate robust competition.[6]

Basing cost predictions on the moving target of a perpetually forward-looking proxy must also leave the Commission incapable of fulfilling the Act's mandate for "sufficient," "specific" and "predictable" federal support. How can support ever be "predictable" at the critical time when the decision whether to invest is made and how can any carrier plan for the future when the proxy model used to measure what costs warrant support — and thus warrant construction, upgrading or expansion of its facilities that the marketplace alone would not warrant at reasonable and affordable rates — keeps changing? This inherent uncertainty could significantly impact rural carriers' ability to continue providing high quality infrastructure to their rural customers.

These sections also raise again the fatal flaw in applying a cost model that predicts the

---

[6] See the letter from Professor Alfred Kahn to Chairman Reed Hundt, CC Docket No. 96-98, dated January 14, 1997 (Challenging FCC's use of "blank slate" costs of wholly new-technology networks instead of actual incremental costs and reasonable markups).

same costs for carriers that do not operate the same type of network or even shoulder the same regulatory obligations. In these circumstances, a reasonable cost estimate for the market facts confronting one set of carriers, such as CLECs that construct almost none of the facilities required for their service offerings, can only be unreasonable for the heavily regulated, facilities-based carrier of last resort. Even if the dilemma of applying forecasts for a hypothetical network to disparate market participants could be solved, the proxy models would not mimic competitive cost incurrence and recovery. Predictions for investment, expenses, network design, costs and pricing based on the proposed static monopoly proxy models cannot survive the very forces the proxies claim to replicate — marketplace competition. The Commission's plan to create competitive market attributes by regulatory fiat is doomed by its faulty premise that regulators can replicate or even validly predict how genuine competition would turn out. No matter how much detail and how many variables the Commission builds into its proxy model project, the model presumes a network designed to serve an entire area and all that area's customers with optimal efficiency. The proxy model will be worthless as soon as competition divides the customer base, concentrates customer shifts where the greatest opportunities for profit emerge and replaces the sole-source service economies and efficiencies the models are designed to exploit with the dynamic resource allocations through which genuine competition pursues optimal efficiency.

ISSUE ONE — III.C.5, 7, 8 & III.D PLATFORM ISSUES

General Support Facilities — ¶¶ 142-148

The Commission's notion of removing the costs of "nonregulated activities" from the General Support Facilities component of a proxy cost-prediction model creates more problems

than it resolves. If only the high costs of investments necessary for activities involved in providing universal services are to be considered, there is obviously a need to exclude substantially, if not all, of the costs of essentially unregulated CLECs. Their undertaking to provide "universal services," the terms on which they provide them and the area and customers which the undertaking covers are all essentially within the CLEC's discretion. Thus, a valid proxy model must provide for individualized factors, ratios or inputs that will reflect the fundamental differences in the type and extent of costs they incur, in contrast to their competitors, the pervasively regulated ILECs. The relationship between the investments involved in providing mandatory facilities-based universal service throughout a historical service area and an ILEC's overall plant investment cannot rationally be assumed to be the same or even similar to the relationships for carriers that choose freely whether to build each component of their networks or use the incumbent's network via resale or unbundled element arrangements secured on preferential, government-ordained terms. In short, the Commission's conclusion (¶ 145) that "u niversal service support should only provide support for the regulated costs of local exchange service" dictates a different and smaller high cost component for GSF for CLECs than for ILECs.

The proposal to vary land values by state (¶ 148) incorrectly assumes that land costs within a state are uniform, when, in fact, the variance between more rural and urban areas or different parts of any state are typically widely divergent. Once again, the issue of geographic cost variability illustrates that improvements in a proxy's accuracy depend largely on the extent to which the model permits individualized inputs tied to actual market facts.

Depreciation — ¶¶ 149-155[7]

Expenses — ¶¶ 155-173

The pervasive differences that militate against applying one simple proxy to all local exchange providers are also pronounced in the area of expenses. For example, the models should include — for ILECs only — individual inputs for expenses to meet the many FCC and state regulatory requirements that apply to them but not to their competitors, including the expenses they incur to provide interconnection, resale and unbundled elements to their competitors pursuant to section 251(c).

Some of the Commission's suggested expense assumptions could increase the complexity of the proxy cost methodology without improving accuracy and reliability. For example, plant mix can materially affect maintenance expense. Nevertheless, the value of varying proxy maintenance expense estimates depending on plant mix (¶ 162) would be minimal if the plant mix is the predicted plant mix of a network based on a hypothetical efficient forward-looking technology different from what a high cost universal service provider has deployed. Greater detail does not increase a proxy's validity when the model itself is invalid, generally or for small and rural ILECs. Moreover, the effect of climate or soil type on the design and operation of an

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[7] Although depreciation is not listed in the platform issues for comment at this time, and TDS Telecom does not have enough information about the non-rural providers to comment in detail on inputs and default values, the need for flexibility to accelerate depreciation in a competitive environment is beyond question. The depreciation practices prescribed in the past for ILECs put them in a different situation than newer carriers that have not accumulated the baggage of years of monopoly regulation. Depreciation is an element considered when ILECs make budget and network design decisions. The Commission needs to act promptly to fulfill its promise to deal with the embedded, legacy or historic cost dilemma for ILECs. Until it has done so, it cannot disregard this critical difference between the actually-incurred and unrecovered costs of ILECs and CLECs in any competitively neutral high cost support calculations.

actual network is significant. However, the impact of rocky soil or frequent flooding on the costs of serving a rural area hypothetically deemed to be most efficiently served by a new, improved radio technology will not tailor the proxy model's ability to produce "sufficient," "specific" and "predictable" high cost support to achieve the 1996 Act's universal service goals in a rural area served by a wireline carrier. The model fails to recognize that no carrier may find the rural market profitable enough to deploy the specified new technology network. Nor would a proxy cost based on that wireless technology provide the right level of support for a competitor using its already existing cable television facilities, for example, to serve only the densest population concentration within the ILEC's area. In that case, the theoretical network could unlawfully provide the competitor with windfall support exceeding the competitor's actual costs for providing universal service.

Predicting "forward-looking" expenses based on historical information specific to the historical networks of the ILECs presents the problem of how to forecast the expenses of a hypothetical new network using information about ILEC past expenses, whether gleaned from a survey or from ARMIS reports. The resulting prediction is not relevant to the future expenses any individual ILEC may reasonably expect to encounter in its own operations. For a CLEC, the historical expense pattern experienced by the incumbent is not likely to be accurate because a competitor is not likely to construct or operate the full facilities-based network the model assumes. With the ILEC's facilities already in place and the promise of favorable terms for CLECs, designed to jump start competition, the CLEC is likely to combine partial construction with unbundled elements or resale. Its operations and expenses will be quite different from the ILECs' past experience and from the expenses that would be encountered if anyone ever built the

imaginary proxy network. The use of ratios based on the model's prediction of investment would, thus, have little value in predicting expenses that either ILECs or CLECs would encounter.[8]

. In a firm's individualized expense forecasting based on its actual network and historical expense patterns, it might find that some types of expenses correlate better with per-line calculations of historical costs and others with investment levels. Expenses per line may be easier to compare with actual experience, since they are more likely to relate to information ILECs have been compiling and reviewing for trends. But there is no basis for assuming that either per-line historical expense or a ratio of expense to investment will correlate with the expenses of the hypothetical, idealized efficient network developed by a proxy model. Validation will be extremely difficult, since no carrier is likely to replicate the proxy model network, given the Commission's regulatory framework for jump starting competitor services. Until a reasonable basis for forecasting expenses for an imaginary network is found, it is futile to wonder whether hypothetical capital and operating expense forecasts will correspond more closely to historical or hypothetical line counts or investment.

It will certainly not be possible to extend the expense estimates derived here to small and midsize ILECs and for all CLECs, since ARMIS and non-rural ILEC survey data do not even reflect actual historic experience for rural carriers. Density, rather than company or serving area size alone, is likely to be the most important determinant of costs for currently available

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[8] Using a company's own investment to forecast the expenses of a hypothetical network could unfairly penalize or advantage an individual company, based on where it stood in its investment and depreciation cycle when the estimate was made.

technologies. Geographical characteristics, such as terrain and climate, may also need to be taken into account. For example, the expenses incurred by a small ILEC serving flat farmland in Minnesota will likely be significantly less than the costs of serving the more rugged northeastern states. The costs of state and local requirements, such as obtaining construction and right-of-way permits or paying state or local taxes, can also have substantial effects on a firm's capital and operating expenses.

Forecasting forward-looking expenses would be particularly risky for the limited markets served by small and rural ILECs. Forecasting errors magnify the inaccuracies in any model applied to a company without the stability found in large-scale operations with a variety of operating conditions. Forecasts will necessarily be suspect when, as now, marketplace and regulatory policies and technologies are subject to rapid changes and uncertainties. Ongoing changes in the telecommunications industry will inevitably result in shifts in how costs are incurred, both by incumbents and real life competitors, as they make business decisions and contest particular markets.

Any analysis of the proxy model for competing firms' costs must ultimately come back to the "self-invalidation" time bomb built into the proxy proposals: The models do not make any attempt to predict the impact of competition on investment, expenses, available economies of scale, feasible network technology and configuration, market share, density and location of the customers actually served by each individual competing firm or any of the other profound changes from contested markets. These changes will inevitably undermine every assumption built into a monopoly proxy model. In short, all of the forecasts and theories about an optimally efficient network built and operated to serve any entire geographic and customer market will be

made useless if the 1996 Act brings about the dynamic competitive environment that the static proxy proposals fail to reproduce.

Customer Services — ¶¶ 166-168

Carrier-to-carrier customer services are so patently different for ILECs and CLECs is that it inherently discriminatory to adopt a model that does not differentiate between the two dissimilar types of carriers. For example, the NPRM reports (¶ 167) that the Hatfield proxy assigns expenses "associated with the provision of unbundled network elements" on a per-line basis. These expenses, like many others, apply only to incumbent carriers and, in fact, provide pricing benefits (in effect, negative expenses) for CLECs that are better than the terms an average non-carrier customer can obtain. If the same cost predictions are applied to CLECs and ILECs with regard to such expenses, the ILEC's competitive disadvantage is, thus, compounded and the CLEC is given "credit" towards high cost support for phantom costs in violation of the use-of-support requirement in §254(e).

TDS Telecom does not believe that the Commission should ignore the costs of marketing in measuring high cost support. Marketing costs are likely to be both more necessary and higher in a competitive market, particularly where the Commission's policies succeed in jump starting competition in a rural market. For each customer won away by a competitor, the ILEC that has historically provided universal service throughout a thin rural market will lose the revenues for serving that customer and, except for resold service, the high cost support it formerly received for serving that line. Its costs of service almost certainly will not decrease by an offsetting amount. Instead, its costs per line are likely to increase for every lost customer because its economies of scale, already limited by the nature of the area it serves, will be reduced as its customer density

declines. The customers it continues to serve will likely be those that cost the most to serve. Unless more support is made available for the ILEC's remaining high cost lines, its rates will have to increase or the quality of service will decline, or both. Marketing will be essential to preserve as many customers as possible, to minimize the consequent losses in support and efficiency and to keep rural rates, nationwide support levels and service advances in compliance with the §254 universal service principles.

Corporate Operations — ¶¶ 169- 171

For small and rural companies, the Commission should also take into account the constraints imposed by smaller size and limited economies of scale. Neither a percentage of investment nor an expense per access line formula will recognize the minimum or base cost for a carrier of any size to perform a necessary function at all, regardless of efficient management, investment levels or access line count.

The Commission raises questions (¶ 173) about how often and how to reexamine and reset expense estimates under a proxy model. These issues lie at the heart of the reduced incentive to develop modern infrastructure in high cost areas that will inevitably follow from using a hypothetical proxy model to measure high costs. It is inherent in the notion of using forward-looking costs that the assumptions and cost predictions must be regularly updated to maintain their forward-looking perspective. However, each time that a reevaluation takes place, starting with the initial shift from actual historic cost recovery to the proxy model methodology, the revised level of high costs recognized for the purposes of measuring high cost support changes the costs for which high cost support is available. Even if the carrier has an operating network with different costs that it would be wasteful to scrap and replace with the assumed

forward-looking efficient network, its high cost recovery will diminish whenever a more cost effective network becomes technically possible. Knowing the risk that its recovery will erode as technology lowers the costs for which its investment can be recovered from high cost support undermines the LEC's willingness to make the investment and upgrade. Instead of the prospect of recovering its actual investment, subject only to the pressures created by a competitive marketplace, the LEC knows its network investment decisions will be compensated pursuant to a regulatory agency's theory of what costs a firm should be able to recover. Moreover, those theoretical costs will assume an ideally competitive environment although without an optimally efficient network, based on standards that are likely to change as the regulatory agency revises compensable costs to reflect the perceived efficiency gains made possible by changes in technology.

Support Areas — ¶¶ 174-176

TDS Telecom agrees that a proxy model must have the ability to identify the lines in an area to predict the cost per line of serving that geographic area. Even rural service areas with inherently high costs of service typically do not have uniformly high costs throughout the area where a serving carrier today provides universal service. [9] Support will be better targeted to the extent that it can accurately be calculated in geographic units small enough to disclose variances in cost. TDS Telecom also agrees that the use of a smaller geographic unit to predict the necessary amount of support per line requires the ability to associate lines with the geographic

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[9] This fact is the basis for the rural ILECs' arguments that they should be allowed to disaggregate the high cost support they receive to correspond to such cost variations, especially if their competitors receive "portable" support for lines they attract to their competitive services based on the incumbents' per line support.

area. Geo-coding would be the best source of an area's line distribution data. However, TDS Telecom ILECs often find it difficult to track housing locations, given the lack of an automated system able to perform this function. Manual maps would be difficult to correlate with a computer database that did not generate its own maps, even if manual maps could be kept current. Competition and number portability will complicate the process. Moreover, while TDS understands that some large LECs have (or soon expect to have) geo-coding ability, that is not the case for rural ILECs. They are thus not in a position to associate lines with CBG, grid or CB units.[10]

Assigning the lines within a support area — and within the cost area with which it is associated — is necessary, but is not enough. In order to measure high cost, the model must be modified to adjust the line assignment or at least the line count to reflect the level of competition — the lines that may shift to another carrier and the resulting impact on the cost per line of the remaining lines. Only with that level of sensitivity can the model prevent the errors introduced by applying the monopoly models the Commission is considering to any carrier that does not serve 100% of the available lines in the support area. If the Commission decides in the future to differentiate the support for primary and non-primary lines, as it has indicated it may, the line identification process must include the appropriate classification in this respect. If the Commission wishes to be able to adopt a proxy cost model for rural areas, the ability to adjust the cost per line in response to shifts in lines from carrier to carrier will be particularly important.

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[10] The Commission should also keep in mind that the 1996 Act requires the Commission to designate eligible carriers on the basis of serving the current study areas (unless duly changed following a Joint Board recommendation) with respect to areas served by "rural telephone companies," as defined in section 3(47), 47 U.S.C. §153 (47).

Indeed, such adjustments to real world conditions are legally required, given (a) the statutory requirements for number portability and "sufficient," "specific" and "predictable" support for universal service and (b) the likely increase in cost per line of an ILEC's remaining high cost lines when lower cost lines — or lines but not an offsetting level of costs — are lost to competitors that resell the ILEC's subsidized higher cost lines and thus avoid the costs of serving the most costly lines. In this regard, the Commission should keep in mind that the local exchange market is relatively inelastic. While competition for interstate toll services expanded the marketplace, allowing growth to offset revenue losses and stranded costs for the competing carriers, local competition is not likely to increase subscriber demand for rural ILECs' lines.

ISSUE TWO — SECTION IV

Support for Local Usage — ¶¶ 178-178

TDS Telecom agrees with the Commission's tentative conclusion (¶177) that universal service should include support for a local usage component to avoid bias in favor of carriers that may charge lower flat monthly local rates, but higher per-minute charges. However, the need to define universal service in a way that will not (a) confer an unwarranted advantage on some competitors or technologies or (b) deny some customers the full benefit of universal local exchange service is not confined to the need for a local usage component. It will require clearer definitions of both "universal service" and "local" than have been necessary in the past, when support was available only for a single universal service provider with defined local exchange boundaries and relatively uniform rate structures.

In rural areas, for example, the problem of inequality in the benefits of universal "local exchange" service exists for some short haul toll rates. Calls that would be local in a

metropolitan area and covered by local rates — for example, calls to the family doctor, emergency or social services, libraries, schools and government agencies — are often toll calls for rural subscribers. The Commission should recognize the need to define and support "local service" and "universal service" to include calling to the subscriber's community of interest. Otherwise, it will not be providing support for the same universal service benefits to rural customers.[11]

The effort to put subscribers of different providers, with different rate structures and service offerings, on an equal footing will be a difficult task. Does eligibility for "universal service" require the receiving provider to deduct the support from whatever combination of flat monthly local and local usage charges it applies to service within the definition of universal service? It is not clear what geographical areas or types of service fall within universal local exchange service. The NPRM's query about how to treat Internet usage in exploring the average customer's average call length illustrates the problem of distinguishing different types of use that are made of telecommunications networks. The statute anticipates that the definition of universal service will evolve, 47 U.S.C. § 254(c)(1), although the Commission's initial definition is conservative, limiting universal service to voice grade service and specified functions and capabilities. However, the definition does not provide guidance about how to deal with premium services that can be used, in part, for voice grade local telephone service or how to segregate the universal service component when an essentially unregulated designated eligible carrier provides some universal service functions as an integrated service package, under a bundled rate structure,

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[11] One way to address this problem of non-comparability would be in setting the benchmark for universal service support.

with no obligation to segregate any of its costs.

The meaning of "local service" or "local rates" is also greatly complicated by the transition to "portable" universal service support. Wireless providers, for example, often charge a single rate for service throughout an area that includes many traditional (ILEC) local exchange service areas and even co-mingles calling within a single town or city with traditional state-to-state toll service under a uniform area-wide flat rate and additional per minute charge. What segment of this service is local universal service and local usage? In particular, how can the Commission enforce the statutory directive that federal universal service support must be used only to provide the services for which the support is provided?

TDS Telecom respectfully suggests that the local usage issue, difficult in its own right, opens a Pandora's box of troubling issues that the Commission must tackle and resolve in order to meet the statutory universal service requirements and its own "competitive neutrality" standard. It should not delay in tackling these issues, since it will be requiring portable high cost support in non-rural ILEC areas beginning January 1, 1998.

Conclusion

TDS Telecom urges the Commission to refrain from adopting a FLEC measurement for non-rural LEC areas based on an imaginary, constantly changing, optimally efficient network because none of the proxy proposals can be shown to satisfy the statutory requirements for universal service. Applying the purported costs of a single network that presumes sole source precision to companies that are subject to competition and are fundamentally different in many respects dooms such a proxy model to inaccuracy in a competitive environment. Relying in part on historical information about the facilities-based networks of highly-regulated large ILECs will further impede the proxy cost model's value for predicting costs and calculating support at a lawful level for their essentially unregulated competitors. The results of a cost methodology so remote from real, market-specific and carrier-specific facts will be even more inaccurate and invalid if extended to the extremely disparate costs and conditions that characterize rural ILECs.

Respectfully submitted,

TDS TELECOMMUNICATIONS
CORPORATION, INC.

Margot Smiley Humphrey

By: /s/Margot Smiley Humphrey
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October 17, 1997

CERTIFICATE OF SERVICE

I, Sheila V. Hickman, a secretary in the office of Koteen & Naftalin, L.L.P. hereby certify that true copies of the foregoing Comments of TDS Telecommunications Corporation, Inc., have been served on the parties on the attached service list, via first class mail, postage prepaid, on the 17th Day of October, 1997.

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Sheila V. Hickman

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