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

DOCKET NO. 98-77

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)
)
)
Access Charge Reform for Incumbent)
Local Exchange Carriers Subject to)
Rate-of-Return Regulation)
)
)
_____)

CC Docket No. 98-77

REPLY COMMENTS OF AT&T CORP.

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SUMMARY

In its Comments, AT&T demonstrated both that the rate-of-return LECs' access charges are substantially higher than the price cap LECs' rates and that this growing disparity is placing severe pressure on the system of nationally averaged long-distance rates. As AT&T proposed in its Comments, the Commission should immediately address these problems by initiating a proceeding to lower the rate-of-return LECs' authorized rate-of-return, and it should also peg the rate-of-return LECs' usage-sensitive access charges to the price cap LECs' and permit the rate-of-return LECs to recover the difference in their revenue requirement and their pegged rates from the USF

The commenters broadly acknowledge these rate disparities and the impact they have on the Commission's policies of nationally averaged long-distance rates and universal service. Although a number of commenters urge the Commission to postpone sorely needed access reform until it conducts its universal service proceeding for rate-of-return LECs in 2001 (or later), AT&T's proposal addresses these commenters' concerns more directly and much more effectively. Therefore, as explained below in Sections I and II, the Commission should adopt AT&T's proposal immediately, and it should implement the various rate structure changes proposed in the NPRM to ensure that the rate-of-return LECs' rate structures are the same as the price cap LECs'

As shown in Section III, although a number of commenters urge the Commission to adopt various "pricing flexibility" measures for the rate-of-return LECs, the Commission properly recognizes in the NPRM that such measures should be considered in a subsequent

proceeding and should await the development of competition. Finally, as demonstrated in Section IV, the Commission should allocate a portion of General Support Facilities-related costs to the billing and collection category, as proposed in the NPRM and as already adopted for the price cap LECs.

reduce the rate-of-return LECs' authorized rate-of-return. AT&T also proposed to peg the rate-of-return LECs' usage-sensitive access charges to the nationwide average of the price cap LECs, and permit the rate-of-return LECs to recover the difference between their revenue requirement and their newly-reduced rates from the Universal Service Fund ("USF").

The commenters largely echo the concerns that underlie AT&T's proposal. A number of commenters note the disparity in usage-sensitive rates between the rate-of-return LECs and the price cap LECs and its adverse effects on nationally averaged long-distance rates. Although many of these commenters argue that the Commission should postpone access reform until the Commission's planned universal service proceeding (which is to be no earlier than 2001), AT&T's proposal addresses these concerns far more effectively. The Commission should act now to redress these distortions and place the rate-of-return LECs on a more equal footing with the price cap LECs

In Section I of these Reply Comments, AT&T addresses the need to reduce the rate-of-return LECs' rate levels and to link access reform to interim universal service funding. In Section II, AT&T discusses the changes the Commission should make in the rate-of-return LECs' rate structures. In Section III, AT&T addresses the rate-of-return LECs' premature and ill-founded requests for pricing flexibility. In Section IV, AT&T explains the need to remove non-regulated billing and collection costs from regulated interstate access charges.

I. THE COMMENTS CONFIRM THAT ACCESS CHARGE REFORM SHOULD BE DONE IN TANDEM WITH INTERIM UNIVERSAL SERVICE FUNDING.

A number of commenters urge the Commission to postpone access reform until it adopts a new universal service system for rate-of-return LECs, which is to take place no earlier than 2001. These commenters express concern that reform of access charges without simultaneous universal service reform could leave rate-of-return LECs unable to collect enough revenues to recover their costs, thereby threatening universal service.³

Rather than postponing sorely needed access reform, the Commission should adopt AT&T's proposal, which directly addresses these commenters' concerns. *See* AT&T at 5-8. As AT&T showed in its Comments (at 5-6 & Attachment 1), the rate-of-return LECs' access charges today are substantially higher than the price cap LECs' access charges. Moreover, that disparity is growing, as the price cap LECs' rates continue to decrease through X-Factor reductions and other mandated changes. These glaring disparities are putting severe pressure on the Commission's policy of nationally averaged long-distance rates, because the few IXCs that serve rate-of-return LECs' areas are facing increasingly higher costs than other IXCs. But the existing disparities are also harmful to the rate-of-return LECs themselves, because it places them at a competitive disadvantage and discourages IXC entry into the rate-of-return LECs' territories. *See, e.g.* NECA at 2 (noting that access reform in isolation will likely increase the rate-of-return LECs' carrier common line ("CCL") rates "even while price cap

³ USTA at 4; ITCs at 2; the Associations at 2-4; OPASTCO at 16-17; TDS at 2-8; Home at 4; NECA at 1-4; Minnesota Coalition at 4-5; Vitelco at 6-7.

companies' CCL rate moves toward zero," which would "increase current rate disparities between ROR and price cap LECs" with "possible adverse impacts on universal service").

The answer to these dilemmas, as AT&T showed in its Comments (at 7-8) and as others agree,⁴ is to peg the rate-of-return LECs' traffic-sensitive access rates to the nationwide average of the price cap LECs' comparable rate elements. The rate-of-return LECs would then be permitted to recover the difference between their revenue requirement and the newly-reduced rates from the USF. This proposal would remove the disparities in access charges and thus relieve the pressure on the policy of nationally averaged long-distance rates. It would also keep the rate-of-return LECs whole (after the reduction in their authorized rate-of-return⁵), which would directly address the LECs' concerns that pursuing access reform in advance of universal service reform could have adverse impacts.⁶

⁴ See the Associations at 19 (because CCL rates are high, Commission must be "vigilant" with respect to the policy of nationally averaged long-distance rates and the incentives to serve rural area customers, and "should consider using a universal service mechanism such as Long Term Support"); TDS at 21 ("if usage sensitive recovery threatens geographically averaged long distance rates, the Commission should consider universal service fund recovery").

⁵ As AT&T showed in its Comments (at 6-7), the rate-of-return LECs' authorized rate-of-return should be reduced to reflect the dramatic changes in economic realities that have occurred since 1990, when these companies' current rate-of-return was established.

⁶ AT&T's proposal is far superior to Home's "interim pool" proposal, in which a surcharge would be assessed on IXCs only. See Home at 6-7. The difference between the rate-of-return LECs' revenue requirement and nationally averaged usage-sensitive rates should be recovered from the USF, to ensure that the recovery mechanism is "equitable," "nondiscriminatory," and competitively neutral. See Section 254(d); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 Report and Order, 12 FCC Rcd. 10095, (continued...)

The Commission should address these increasingly serious problems now, and should not postpone addressing them until it conducts its universal service proceeding for rate-of-return LECs in 2001 (or later). AT&T's proposal is a workable interim solution that both eliminates the current distortions in the rate-of-return LECs' rates while simultaneously holding the rate-of-return LECs "harmless" pending permanent universal service reform. The Commission should act quickly; it should not wait years, and allow these problems to fester and worsen.⁷

II. THE COMMISSION SHOULD ALSO MODIFY THE RATE-OF-RETURN LECs' RATE STRUCTURES TO MAKE THEM CONSISTENT WITH THOSE OF THE PRICE CAP LECs.

As AT&T previously demonstrated (at 3-4), the Commission should modify the rate-of-return LECs' rates structures to make them consistent with those of the price cap LECs, as proposed in the NPRM. A number of LEC commenters, however, urge the Commission to abandon the NPRM's tentative conclusions and to adopt other changes that would leave their rate structures at odds with the price cap LECs' rate structures. The Commission should

⁶ (...continued)
¶¶ 46-48 (1997).

⁷ As AT&T explained previously (at 8-12), if the Commission does not adopt AT&T's proposal concerning interim USF funding, it should relieve pressure on the system of nationally averaged rates by targeting all reductions in the CCLC and Transport Interconnection Charge ("TIC") to originating rates first, then to terminating rates. See TANE at 6-7 (Commission should allow rate-of-return LECs to recover the increased CCL charges through terminating rates, to reduce disparities with price cap LECs' originating CCL rates).

reject these arguments. For the most part, the changes the Commission adopted in the *Access Reform Order* for the price cap LECs were long overdue and resulted in rate structures more consistent with principles of cost-causation, and the Commission should adopt those changes here for the same reasons and to promote administrative efficiency. AT&T at 3-4. The commenters have not presented any compelling reasons to do otherwise.

In particular, some commenters argue that the rate-of-return LECs' Subscriber Line Charges ("SLCs") and Presubscribed Interexchange Carrier Charges ("PICCs") should be capped at the nationwide average of the price cap LECs' SLCs and PICCs, which these commenters claim is necessary to avoid placing them at a competitive disadvantage.⁸ The Commission should reject these arguments for several reasons. The Commission has already found that the caps adopted for the price cap LECs result in rates that are affordable and do not threaten universal service.⁹ Indeed, a number of price cap LECs have tariffed SLCs and PICCs at the caps,¹⁰ and there is no evidence that such pricing has resulted in migration of

⁸ USTA at 10-11, 14-15; NECA at 4-5; TANE at 7-8; the Associations at 18, 21; OPASTCO at 3-4; TDS at 13-17; Home at 5-6; JSI at 10; Minnesota Coalition at 9.

⁹ *Access Reform Order*, ¶¶ 75-80.

¹⁰ These LECs include: U S WEST in Colorado, Idaho, Montana, New Mexico, Oregon, and Wyoming; GTE in Alabama, Arkansas, California, Idaho, Iowa, Kentucky, Missouri, South Carolina, Virginia, Washington, Wisconsin; GSTC in Alabama, Arkansas, Kentucky, Missouri, New Mexico, North Carolina, South Carolina, Texas, Washington; and Sprint in Kansas, Missouri, Nebraska, Oregon, South Carolina, and Wyoming.

businesses out of rural areas. Moreover, common line costs should be recovered from the end-user to be consistent with principles of cost-causation.¹¹

For these reasons, as AT&T made clear in its Comments, the Commission should adopt the same caps for SLCs and PICCs as it ultimately adopts for the price cap LECs. In that regard, numerous parties have challenged the Commission's decisions to create separate SLCs and PICCs for "primary" and "non-primary" lines. Many commenters in this proceeding also oppose this distinction and argue that it should not be applied to the rate-of-return LECs.¹² As AT&T and others have shown elsewhere,¹³ the Commission should eliminate the primary/non-primary line distinction and set the residential SLC and PICC rate caps at levels that represent the weighted average of primary and non-primary lines that the Commission contemplated in the *Access Reform Order*.¹⁴ Whatever approach the

¹¹ See, e.g., *Access Reform Order*, at ¶ 77. Furthermore, there is no merit to the suggestion of some commenters that capping SLCs and PICCs at the nationwide average of the price cap LECs is required by the principle of Section 254(b)(3) that rates in urban and rural areas should be "reasonably comparable." See Minnesota Coalition at 7-8; the Associations at 17-18; OPASTCO at 3; TDS at 13-14; JSI at 8-9. First, the comparability standard is merely one of several competing universal service "principles;" it is not an absolute requirement. Even so, the comparability standard cannot be interpreted to require equality for all individual rate *elements*; so long as overall rates are reasonably comparable (and the commenters offer no evidence that they are not), the principle is satisfied. The Commission already provides substantial universal service support through the USF to keep rates in rural areas reasonably comparable to those in urban areas

¹² USTA at 10; NECA at 5-6; OPASTCO at 14-15; the Associations at 26-28

¹³ See *Definition of Primary Lines*, CC Docket No. 97-181, Comments of Sprint at 1-1 (filed September 25, 1997); *id.*, Reply Comments of AT&T Corp. at 2-3 (filed October 9, 1997).

¹⁴ Contrary to NECA's suggestion (at 5), the Commission should in no instance grant the
(continued...)

Commission adopts, however, it should apply equally to the price cap and the rate-of-return LECs.¹⁵

In addition, a number of LEC commenters oppose the Commission's proposals concerning reallocation of certain costs from the TIC into other rate elements.¹⁶ These claims are ill-founded for several reasons. Most fundamentally, these commenters simply ignore the D.C. Circuit's decision in *Competitive Telecommunications Ass'n v. FCC*, 87 F.3d 522 (D.C. Cir. 1996), in which the court ordered the Commission to eliminate the TIC entirely (or provide an adequate explanation why it should be retained). Under AT&T's proposal, the Commission would peg the rate-of-return LECs' TIC to the price cap LECs' TIC -- which would ultimately reduce it to zero -- and the Commission should adopt a further mechanism to phase out over a reasonable time period the TIC revenues that would be transferred to the USF under AT&T's plan. See AT&T at 8 n.8.

The Commission should also reassign costs from the TIC as proposed in the NPRM (at ¶¶ 67-68), and should shift line port costs and marketing expenses to the common line element (NPRM at ¶¶ 54, 86), to ensure that such costs are recovered in a cost-causative

¹⁴ (...continued)

rate-of-return LECs the ability to unilaterally deaverage SLCs and PICCs on an individual case basis.

¹⁵ As GCI notes, the Commission should also require the LECs to provide IXCs information sufficient to identify what type of line is being served -- *i.e.*, primary residential, non-primary residential, or single-line or multiline business. GCI at 5.

¹⁶ See USTA at 20-22; the Associations at 29-30; TDS at 20; TANE at 8-9; Vitelco at 10.

manner. The commenters offer no reason to do otherwise except their generalized concern that pressing ahead with access reform prior to the establishment of the new universal service system could have adverse effects. As explained above, however, AT&T's proposal addresses these concerns by providing interim USF funding to the extent that the rate-of-return LECs' usage-sensitive rates would otherwise exceed the nationwide average of the price cap LECs' comparable rates.

III. THE RATE-OF-RETURN LECs REQUESTS FOR PRICING FLEXIBILITY ARE PREMATURE AND, IN ALL EVENTS, SHOULD BE REJECTED.

The Commission should reject the claims of some commenters that rate-of-return LECs should be granted greater flexibility in the pricing of access charges. These commenters claim that, because of the potential for competition, they should be given "modest pricing flexibility," including permitting "zone pricing of SLCs, PICCs, and the CCL charge within each study area served by a rate-of-return LEC that has exited or does not participate in the pooled NECA common line tariff." USTA at 24; "zone pricing for local switching elements," *id.* at 26; and the "latitude to provide" "[t]erm and volume discounts," ALLTEL at 7.

The rate-of-return LECs' proposals are premature. In the NPRM, the Commission specifically held that "*i/n a subsequent phase of this proceeding, we intend to address the very difficult question of when, and how much, additional pricing flexibility should be afforded to rate-of-return LECs.*" NPRM, ¶ 5 (emphasis added). Thus, the rate-of-return

LECs have improperly raised these issues at this juncture. Any action taken on the basis of the rate-of-return LECs' present, unsupported assertions would be inappropriate.

In all events, the rate-of-return LECs' proposals cannot withstand scrutiny. The alleged benefits of pricing flexibility will not outweigh the corresponding dangers (*i.e.*, cross-subsidization and predatory pricing) until local markets are sufficiently competitive to prevent rate-of-return LECs from engaging in discriminatory, anticompetitive practices. As the Commission has recognized, such competition does not presently exist, and likely will be slow to develop. *See* NPRM, ¶ 12 ("[w]hile the entry of competitors in many rate-of-return LEC service areas may be delayed due to the provisions of section 251(f), entry in these areas will likely occur in time").

As the Commission also has recognized, "[w]hile rate-of-return LEC costs generally may be higher than price cap LEC costs due to longer loops or lower economies of scale, the two groups of carriers incur costs in the same manner, *and similar economic principles should apply.*" NPRM, ¶ 3 (emphasis added). Thus, until the rate-of-return LECs can demonstrate, under objective criteria, the existence of meaningful local competition, the Commission should maintain detailed regulatory controls and procedures in the same way, and for the same reasons, as it maintains those controls with respect to the price cap LECs. *Cf. Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd. 8961, 9002 (¶ 92) (1995).

The Commission's existing regulatory procedures are necessary in the rate-of-return LEC context, because they are designed in part to protect customers and potential

competitors from the anticompetitive practices that pricing flexibility can foster -- cross-subsidization and predatory pricing.¹⁷ For example, general zone deaveraging would enable LECs to cross-subsidize rates in competitive, high density zones with rates in noncompetitive, low-density zones. Similarly, expanding the rate-of-return LECs' ability to offer volume and term discounts would allow them to undercut their competitors' prices through cross-subsidizations from noncompetitive areas, and could present a significant barrier to entry in emerging competitive markets by locking customers into long term contracts and preventing them from participating in the evolving marketplace. Accordingly, the Commission has correctly concluded that such discounts should be considered with great caution.¹⁸ Finally, contrary to the suggestions of a few commenters,¹⁹ the Commission should not permit rate-of-return LECs to exit the NECA common line pool on a study area basis by repealing the so-called "all or nothing" rule (47 C.F.R. § 69.3(e)(9)). Permitting

¹⁷ As the Commission previously noted:

Some parties have sought to equate pricing flexibility with the ability to engage in predation against the newly formed alternative access industry, or to engage in cross-subsidization to the detriment of particular classes of customers. We believe that the limited amount of pricing flexibility available to LECs . . . will not grant a license to LECs to engage in predation or cross-subsidization.

Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd. 6786, ¶ 36 (1990).

¹⁸ *Expanded Interconnection with Local Telephone Company Facilities*, 9 FCC Rcd. 5154, 5204, ¶ 183 (1994).

¹⁹ USTA at 25; ALLTEL at 7-8; TDS at 23.

such exit would destroy the rebalancing of rates that currently occurs within the pool, and the inevitable result would be that LECs would remove their low-cost study areas from the pool and leave their high-cost areas in the pool, thus driving the NECA pool rates higher.

New entrants will not be able to ward off these anticompetitive dangers until local competition becomes ubiquitous enough to prevent the rate-of-return LECs from charging above-cost rates in certain areas or with respect to certain customers. Thus, if true competition is to develop, the Commission's regulatory safeguards must continue to protect the interest of customers and competitors in the near term. In any event, these are issues that the Commission has indicated it will address in future proceedings, and need not be considered here.

IV. THE COMMISSION SHOULD MODIFY ITS RULES TO ELIMINATE COST MISALLOCATIONS RELATING TO GENERAL SUPPORT FACILITIES COSTS.

As the Commission recognized in the NPRM (at ¶¶ 79-80), the current rules improperly permit the rate-of-return LECs to recover costs that are associated with their nonregulated billing and collection functions through their regulated interstate access rates, and the Commission now proposes to correct this anomaly. NPRM, ¶ 82. AT&T fully supports the Commission's proposal. *See* AT&T at 13-15. Although the rate-of-return LECs concede that "the principle of allocating costs of non-regulated services to non-regulated accounts is sound," the Associations at 29, they urge an exception in their case because they claim that many rate-of-return LECs do not perform their own billing functions but instead

rely on the services of outside vendors. NECA at 6-7 (use of outside vendors means that "[a]llocating additional [General Support Facilities ("GSF")] costs to the [Billing and Collection] category would . . . result in underrecovery of these costs by small ROR LECs").

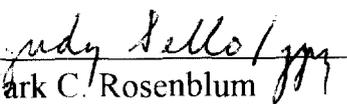
The rate-of-return LECs' response is insufficient to remedy the Commission's concerns. First, although it is uncertain how many rate-of-return LECs rely on outside vendors for the provision of billing and collection services, it is clear that *some* do not. See the Associations at 31 (estimating that 40% of their members use such vendors). Such rate-of-return LECs thus are in the same position as most price cap LECs and, accordingly, the Commission's GSF cost reallocation principles should apply with equal force.

Further, even for rate-of-return LECs that *do* rely on outside vendors for the provision of billing and collection services, additional procedures are necessary to ensure that nonregulated billing and collection costs are not recovered through regulated interstate access charges. Most importantly, the costs associated with outside vendor contracts directly pertain to the provision of nonregulated billing and collection services, and thus the Commission should ensure that these costs are not recovered through regulated interstate access charges. Further, even if outside vendors are used for the provision of billing and collection services, the rate-of-return LECs nonetheless may incur GSF or other expenses related to these services. The Commission therefore should establish procedures, either through a separate rule or through a waiver process, to ensure that these costs also are excluded from interstate access charges.

CONCLUSION

For the foregoing reasons and those in AT&T's Comments, the Commission should modify its rules concerning access charges for LECs subject to rate-of-return regulation to the extent described above.

Respectfully submitted,


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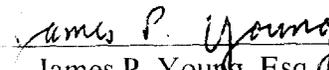
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AT&T Corp. ("AT&T")
Baca Valley Telephone Company ("Baca Valley")
Bristol Bay Telephone Cooperative, Inc ("Bristol Bay")
Central Montana Communications, Inc. ("Central Montana")
Clear Creek Mutual Telephone Company ("Clear Creek")
General Communication, Inc. ("GCI")
Hardy Telecommunications, Inc. ("Hardy")
Home Telephone Company, Inc. ("Home")
Independent Telephone & Telecommunications Alliance ("ITTA")
ITCs, Inc. ("ITCs")
John Staurulakis, Inc. ("JSI")
Kingdom Telephone Company ("Kingdom")
Midvale Telephone Exchange, Id ("Midvale")
Minnesota Independent Coalition ("Minnesota Coalition")
Molalla Telephone Company ("Molalla")
National Exchange Carrier Association, Inc. ("NECA")
National Rural Telecom Association ("NRTA") and the National Telephone Cooperative
Association ("NTCA") ("the Associations")
North-State Telephone Company ("North-State")
Oregon Telephone Corporation ("Oregon")
Organization for the Promotion and Advancement of Small Telecommunications
Companies ("OPASTCO")
Pine Telephone System, Inc. ("Pine")
Rockland Telephone Company ("Rockland")
Roosevelt County Telephone ("Roosevelt")
Southern Montana Telephone Company ("Southern Montana")
TDS Telecommunications Corporation ("TDS")
Telephone Association of New England ("TANE")
Triangle Telephone Cooperative Association, Inc ("Triangle")
United States Telephone Association ("USTA")
United Utilities, Inc. ("United")
Virgin Islands Telephone Corporation ("Vitelco")
Western Alliance
West River Telecommunications Cooperative ("West River")

CERTIFICATE OF SERVICE

I, James P. Young, do hereby certify that I caused a copy of the foregoing Reply Comments of AT&T Corp. to be served this 17th day of September, 1998, by First Class mail, postage prepaid, on all parties on the attached Service List.


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