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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for	)	CC Docket No. 00-256
Regulation of Interstate Services of	)	
Non-Price Cap Incumbent Local Exchange	)	
Carriers and Interexchange Carriers	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	
Access Charge Reform for Incumbent	)	CC Docket No. 98-77
Local Exchange Carriers Subject to	)	
Rate-of-Return Regulation	)	
	)	
Prescribing the Authorized Rate of Return For	)	CC Docket No. 98-166
Interstate Services of Local Exchange Carriers	)	

TO: The Commission

COMMENTS OF THE INTERSTATE TELCOM GROUP

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Dated: February 26, 2001

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SUMMARY

Interstate Telcom Consulting, Inc. and fifty-eight of its rural telephone company clients ("the Interstate Telcom Group") generally support the interstate access proposals in the Multi-Association Group ("MAG") Plan. These proposals will reduce the uncertainty that has plagued the rural telephone industry regarding the future of critical interstate access revenues, and will create an environment more conducive to the deployment of advance services in rural areas. At the same time, the MAG Plan affects well less than 10 percent of nationwide access lines and interstate access revenues, and will not have an adverse impact upon the interstate access costs or interstate long distance toll charges of interexchange carriers.

The Interstate Telcom Group has focused on five issues. First, the option for rural telephone companies and other local exchange carriers ("LECs") to remain on rate of return regulation (Path B) must be retained. The Commission has long recognized that price caps and other forms of incentive regulation are designed primarily for larger carriers having relatively stable investment patterns and operating expenses from year to year. In contrast, rural LECs differ significantly not only from larger LECs, but also from each other, in size, scale, network design, operating conditions, investment patterns and other relevant characteristics. Whereas only some Interstate Telcom Group members or other rural LECs are likely to elect to remain on Path B, the flexibility to do so is essential for those rural LECs that are ill-suited for incentive regulation (particularly those with "lumpy" investment patterns and significant year-to-year flucuations in operating expenses).

Second, the Interstate Telcom Group believes that the MAG Plan should be adopted for at least a seven-year initial term, and that both the Path A incentive mechanism and the Path B rate

of return mechanism should remain in effect after the initial term unless and until the Commission determines that technological or economic changes require their modification. It also believes that LECs should be able to convert their study areas from Path B to Path A at any time during the initial term. And it believes that the subscriber line charges (SLCs) of rural LECs should not be increased until January 1, 2002 or later, and that these SLCs should be lower than those of large carriers serving much larger urban and suburban calling areas.

Third, the Interstate Telcom Group opposes the addition of any productivity offset to the proposed Revenue Per Line ("RPL") of Path A. Rural LECs do not have the size or operating scale to support X-factors or consumer productivity dividends like those developed for the large price cap carriers.

Fourth, the Interstate Telcom Group believes that the Low End Adjustment mechanism proposed in the MAG Plan constitutes a safety net that is essential for the preservation of the investment capability and operating viability of those rural LECs on Path A that may experience sharp declines in their cash flow or earnings during a particular period.

Finally, the Interstate Telcom Group believes that business and technological uncertainty have caused the cost of capital and cost of equity of rural LECs to remain at least as high as they were when the existing 11.25 percent rate of return was prescribed. Therefore, the existing 11.25 percent rate should be retained.

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TO: The Commission

COMMENTS OF THE INTERSTATE TELCOM GROUP

Interstate Telcom Consulting, Inc. (Interstate Telcom) and fifty-eight of its rural telephone company clients (collectively, the "Interstate Telcom Group") hereby submit their comments with respect to the Commission's Notice Of Proposed Rulemaking, FCC 00-448, released January 5, 2001, regarding the Multi-Association Group (MAG) Plan. The Interstate Telcom clients participating in these comments are rural telephone companies located in the states of Minnesota, Wisconsin, Michigan, Iowa, South Dakota and Ohio. They include Ace Telephone Association; Ace Telephone Company of Michigan; Amery Telcom, Inc.; Baldwin Telecom, Inc.; Bayland Telephone, Inc.; Bergen Telephone Company; Bernard Telephone Company; Bloomer Telephone Company; Bruce Telephone Company, Inc.; Chequamegon Telephone Cooperative, Inc.; Chibardun

Telephone Cooperative, Inc.; Christensen Communications Company, dba Madelia Telephone Company; Citizens Telephone Cooperative, Inc.; City of Barnesville, dba Barnesville Telephone; Clear Lake Telephone Company, Inc.; Cochrane Cooperative Telephone Company; Coon Valley Farmers Telephone Company, Inc.; Delavan Telephone Company; Dickeyville Telephone Corporation; Farmers Independent Telephone Company; Farmers Mutual Telephone Company (Okolona, Ohio); Farmers Mutual Telephone Company (Bellingham, Minnesota); Farmers Telephone Company (Lancaster, Wisconsin); Hager Telecom Inc.; Harmony Telephone Company; Hillsboro Telephone Company, Inc.; Lakefield Telephone Company; LaValle Telephone Cooperative, Inc.; Lemonweir Valley Telephone Company; Lost Nation-Elwood Telephone Company; Luck Telephone Company; Mabel Cooperative Telephone Company; Manawa Telephone Company, Inc.; Marquette-Adams Telephone Cooperative, Inc.; Mid-Plains Telephone, Inc.; Milltown Mutual Telephone Company; Minburn Telecommunications, Inc.; Minnesota Valley Telephone Company, Inc.; Mosinee Telephone Company; Nelson Telephone Cooperative, Inc.; Niagara Telephone Company; Northeast Telephone Company; Northern Telephone Company; Richland-Grant Telephone Cooperative, Inc.; Sharon Telephone Company; Siren Telephone Company, Inc.; Somerset Telephone Company, Inc.; Spring Grove Cooperative Telephone Company; Spring Valley Telephone Company, Inc.; The Home Telephone Company; Tri-County Telcom, Inc.; Tri-County Telephone Cooperative, Inc.; Union Telephone Company; Vernon Telephone Cooperative, Inc.; West Wisconsin Telcom Cooperative, Inc.; Wilderness Valley Telephone Company; Winthrop Telephone Company; and Wittenberg Telephone Company.

The Interstate Telcom Group generally supports the interstate access proposals in the MAG Plan. It will focus its comments upon the following issues. First, the option for rural telephone companies and other rate-of-return carriers to remain subject to rate-of-return regulation (Path B) must be retained in recognition of the widely varying sizes, networks and operating conditions of these carriers. Second, the initial term of the MAG Plan should be long enough to accommodate the investment cycles of small carriers (that is, at least seven years), and the transition and post-term periods should be administered in a flexible and stable manner. Third, an "X-factor" or other estimated productivity offset should not be included in the proposed incentive plan (Path A), because rural telephone companies and other rate-of-return carriers do not possess the size or economies of scale to accommodate such an offset. Fourth, the proposed Low End Adjustment mechanism should be included to encourage small carriers to adopt incentive regulation, and to protect them from the disruptive impacts of investment and cost fluctuations thereafter. Finally, the existing prescribed 11.25 percent rate of return should be retained to reflect the continuing risks and capital/equity costs of rate-of-return carriers in the changing telecommunications industry and regulatory regime.

Interstate Telcom Group

Interstate Telcom is a telecommunications consulting firm located in Hector, Minnesota. Its five principal employees have over 140 years of collective experience in the telecommunications industry, and it has served rural telephone companies continuously since it commenced operations in April, 1981. Interstate Telecom performs a variety of telecommunications consulting services for rural telephone companies, including cost separation studies, revenue forecasting, access tariff development, depreciation studies, continuing property record maintenance, traffic engineering and analysis, Carrier Access Billing System (CABS) billing and reviews, National Exchange Carrier Association (NECA) reporting, average schedule settlements, access service requests (ASRs), AOCN services, circuit provisioning, business plans and exchange acquisition assistance.

Interstate Telcom's rural telephone company clients range in size from 40 access lines to 25,000 access lines, and are located primarily in the states of Minnesota, Wisconsin, Michigan, Iowa, South Dakota, Ohio and Montana. Interstate access revenues and federal universal service support are extremely important to the finances and operations of these small carriers. Interstate Telcom has studied a representative sample of its clients, and has found that interstate access revenues and federal universal service support comprise an average of 40.56 percent of their revenue bases. These percentages range from a low of 28.06 percent of the revenue base of a small carrier serving a bedroom community near a Wisconsin city, to a high of 78.59 percent of the revenue base of a small carrier in rural Minnesota.

Basic Principles

The Interstate Telcom Group believes that changes in the telecommunications and information industries are making it increasingly necessary to deploy advanced services and broadband facilities in rural areas. If this task is to be accomplished, it will be accomplished in major part by the only entities that heretofore have shown any sustained commitment to the provision of quality telecommunications services to Rural America – namely, existing rural telephone companies. And if rural telephone companies are to make the infrastructure investments necessary to deploy advanced services and broadband facilities, there must be greater certainty and stability regarding the interstate access revenues and federal universal service support that comprise a large and critical portion of their revenue bases.

Competition has arisen in some rural areas, but is not likely to come to large areas of rural Minnesota, Wisconsin, Michigan, Iowa, South Dakota, Ohio or Montana during the next three to five years. Potential local service competitors will continue to focus their efforts predominately in urban and suburban areas where there are larger numbers and percentages of business and other high-revenue customers, and where profit opportunities are much greater. Rather than competition, the primary driver of the deployment of advanced services in rural telephone company service areas will be the demands of their customers for more rapid Internet access and other information tools necessary to allow them and their children to participate more fully in the 21st Century economy.

The deployment of advanced services and broadband facilities is more expensive and risky in sparsely populated rural areas than in urban and suburban areas. In rural Minnesota, Wisconsin, Michigan, Iowa, South Dakota, Ohio and Montana, the longer distances between customers and the harsh winters increase per-line rural construction and maintenance costs above the national average, while the smaller populations of rural exchange areas limit opportunities to realize economies of scale. A significant number of Interstate Telcom clients have begun Digital Subscriber Line (DSL) upgrades, but the need to modify their rural networks to deal with DSL loop length constraints make these projects far more expensive on a per-line basis than urban and suburban DSL deployments. Put simply, Interstate Telcom Group members and other rural telephone companies will have to continue making relatively large and more risky investments to bring advanced services and broadband facilities to their areas.

Unfortunately, during the very same period (1995 to the present) that the Internet explosion and voice/data/video convergence have generated increasing needs for advanced services and infrastructure upgrades, the future interstate access and universal service revenues of Interstate Telecom Group members and other rural telephone companies have been rendered uncertain by the Commission's 1995 inquiry regarding the Universal Service Fund (CC Docket No. 80-286), and by the various proceedings arising out of the Telecommunications Act of 1996 (including CC Docket Nos. 96-45, 98-77 and 98-166). Interstate Telcom Group members simply cannot readily make substantial investments in the infrastructure necessary to support advanced services when facing potentially significant changes in Commission rules affecting approximately 40 percent of their existing revenue streams. One of the primary advantages of the MAG Plan is that it will reduce this uncertainty regarding future interstate access revenues, and restore the ability of small local exchange carriers (LECs) to plan and finance new services and infrastructure upgrades on the basis of more reliable future revenue estimates.

Whereas stable, sufficient and predictable interstate access revenues are extremely important to rural telephone companies and their rural customers, the very small fraction of nationwide interstate access revenues affected by this proceeding will not significantly affect the rates or cost structures of the interexchange carriers paying them. The Commission itself has recognized that rate-of-return LECs serve less than 8 percent of total U.S. access lines, and account for only an approximate 9 percent of total access revenues. Access Charge Reform for Incumbent Local Exchange Carriers Subject to

Rate-of-Return Regulation, CC Docket No. 98-77, 13 FCC Rcd 14238, 14244 (1998). In other words, the Coalition for Affordable Local and Long Distance Service (CALLS) Plan adopted by the Commission in May, 2000 implemented access reform affecting more than 90 percent of access lines and access revenues, and thereby accomplished the lion's share of nationwide access reform. As a result, the Commission is now in a position to deal flexibly and carefully with access mechanisms and revenues that are extremely important to small rural LECs, without adversely impacting the interexchange industry due to the very small portion of nationwide access charges at issue..

The Commission Must Retain
A Rate Of Return Option (Path B) For Small LECs

A cornerstone of this flexibility is the retention by the Commission of a rate of return regulatory option (Path B of the MAG Plan) for small LECs whose "lumpy" investment patterns and fluctuating operating expenses are not suitable for incentive regulation.

The Commission has long recognized that incentive regulation is not feasible for many small LECs. In its LEC Price Cap Order, 5 FCC Rcd. 6786, 6819 (1990), the Commission refused to force small LECs into a regulatory regime based largely on the historical performance of the largest telephone companies, and made price cap regulation optional for all companies smaller than the Regional Bell Operating Companies (RBOCs) and GTE. In Regulatory Reform for Local Exchange Carriers, CC Docket No. 92-135, 8 FCC Rcd 4545, 4546 (1993), the Commission noted that smaller LECs do not want to become subject to price cap regulation because:

> they cannot abandon the risk sharing provided by the NECA pools and the Long Term Support protection . . . without substantial risk to their continued financial viability. Others believe that, because of their small size, their business cycles are

too long to comply with price cap annual adjustments and that the financial effect of facility upgrades is too great to be reconciled within the Commission's price cap framework.

The Commission repeatedly has taken into account the preference of small carriers for rate of return regulation when granting waivers of the "all-or-nothing" and "permanent choice" provisions of Rule 61.41 to permit rural telephone companies to acquire exchanges from price cap carriers without becoming themselves subject to price cap regulation. See e.g. ATEAC, Inc., DA 00-1883, released August 18, 2000; Minburn Telecommunications, Inc., 14 FCC Rcd 14184 (1999); Maine Telecommunications Group, Inc., 9 FCC Rcd 3082 (1994); US West Communications, Inc. and Nemont Telephone Cooperative, Inc., 9 FCC Rcd 721 (1994); US West Communications, Inc. and Triangle Telephone Cooperative Association, Inc., 9 FCC Rcd 202 (1993); and US West Communications, Inc. and South Central Utah Telephone Association, Inc., 9 FCC Rcd 198 (1993).

These same principles apply equally to the MAG Plan. A rate of return option (Path B) must be retained because incentive regulation (Path A) is not feasible for all small LECs. Rather, many small LECs have lumpy investment patterns and significant year-to-year fluctuations in operating expenses that are not compatible with relatively stable incentive mechanisms such as the Revenue Per Line (RPL) factor in the MAG Plan. A substantial short-term expense fluctuation that exceeds a small LEC's incentive revenues for the year can disrupt its operations and investment plans, and render it much more difficult and expensive for it to obtain capital in the future.

Incentive mechanisms work for large carriers like the RBOCs because their size and scale permit the "smoothing" of investment and expense fluctuations. Where a large carrier operates hundreds of exchanges, it can plan and schedule upgrades in a specific portion of the exchanges each year so as to keep its total infrastructure investment relatively stable from year-to-year. Likewise, where a large carrier operates hundreds of exchanges, it can offset substantial increases in the operating expenses of a handful of its exchanges with decreases in the operating expenses of its other exchanges or its administrative offices. In contrast, a small LEC with three exchanges will experience a major jump in company-wide investment in the year that it is required to upgrade one of the exchanges. Likewise, a substantial increase in the operating expenses of one of the small LEC's three exchanges will be difficult or impossible to offset, and is likely to result in an increase in overall company expenses for the year. Rather than promoting rational investment and operation, the application of incentive regulation to small LECs with fluctuating or unpredictable costs is more likely to produce insufficient investment in new infrastructure and technologies, inadequate staffing and training, and degradation of technical and customer service.

The Interstate Telcom Group is **not** saying that its members will predominately elect Path B rate-of-return regulation over Path A incentive regulation. Its members are currently studying both Path A and Path B as presently proposed, and will continue to review them as the Commission proceeds toward a decision. The Interstate Telcom Group believes that some of its members are likely to elect Path A incentive regulation at some time if the MAG Plan is adopted substantially as proposed. The point here is that Path A incentive regulation is not a "one size fits all" solution for Interstate Telcom Group members, much less for all existing rate-of-return carriers. Rather, the Path B option needs to remain available for those LECs whose small scale, lumpy investment patterns and fluctuating costs are not suitable for incentive regulation.

In its White Paper 2, 'The Rural Difference" (January 2000), the Rural Task Force (RTF) found that there are not only material and substantial differences between rural and non-rural LECs, but also significant diversity among rural LECs themselves. The differences among rural LECs include significant variations in study area sizes, customer densities, and terrain and climate conditions. Given the diversity among rural LECs, a "one size fits all" solution is not practicable for either interstate access charges or federal universal service support. Rather, mechanisms reflecting the actual costs of operation in diverse areas are the only mechanisms developed to date that are sufficiently flexible to encourage investment and service upgrades in many rural areas.

The purpose and function of the existing system of rate-of-return regulation and National Exchange Carrier Association (NECA) pooling was to accommodate these differences among rural carriers and rural service areas while maintaining stable rates for interexchange carriers and other access customers. This existing system allowed small rural LECs to bring digital switching, single party service, fiber optic facilities, custom calling features, buried lines and other late 20th Century advances to their rural customers, often long before the RBOCs brought them to neighboring rural areas. The Accounting Policy Division's (APD's) study area waiver files contain numerous examples not only of how rural LECs led their larger counterparts in bringing quality voice services to their rural customers, but also how they purchased and upgraded long-neglected rural exchanges of larger carriers. See e.g. Union Tel. Co. and US WEST Communications, Inc., 12 FCC Rcd 1840 (1997); Pend Oreille Tel. Co. and GTE Northwest, Inc., 12 FCC Rcd 63 (1997); and Accipiter Communications, Inc. and US WEST Communications, Inc., 11 FCC Rcd 14962 (1996). The APD's study area waiver files also show that the promise and record of rural LEC upgrades has resulted in vigorous support for these exchange acquisitions by state and local governments, local business communities, and local residents.

The challenge now is for rural LECs to bring advanced services to Rural America. They can and will accomplish this, but will do so in the near term only if the Commission ends the six-year period of uncertainty regarding interstate access and universal service revenues, and establishes sufficient and stable cost recovery mechanisms. For many small LECs, this means a rate-of-return mechanism like Path B that can accommodate their unique operating circumstances and the needs of their lenders, and not an incentive mechanism that raises fears that they will be not be able to generate sufficient revenues to support broadband investments or other substantial future costs (foreseen or unforeseen).

Finally, the Interstate Telcom Group notes that the potential aggregate cost of the Plan B option is minimal. We are talking here about a fraction of the access lines and access revenues of a group of rate-of-return carriers that, before many of its members elect Path A incentive regulation, serves less than 8 percent of total U.S. access lines and receives only an approximate 9 percent of total access revenues. Put simply, on a national scale, the interstate access revenues received by carriers electing to remain on Path B rate-of-return regulation will have no perceptible adverse impact on nationwide interstate long distance toll rates or the underlying interstate access costs of interexchange carriers. Hence, whereas the Path B option is very important for some small rural LECs and their rural customers, it will not have any discernible adverse impact on interstate toll carriers or their customers.

Certain Transition Issues Need To Be Clarified

The Interstate Telcom Group believes that the MAG Plan should be adopted for at least a seven-year initial term, and that both the Path A incentive mechanism and the Path B rate of return mechanism should remain in effect after the initial term unless and until the Commission determines that technological or economic changes require their modification. It also believes that LECs should be able to convert their study areas from Path B to Path A at any time during the initial term. Finally, it believes that the subscriber line charges (SLCs) of rural LECs should not be increased until January 1, 2002 or later, and that these SLCs should not be as high as those of large carriers serving primarily urban and suburban calling areas.

The proposed five-year term of the MAG Plan will bring much needed certainty and stability to the interstate access revenues of rural and other rate of return LECs. However, a seven-year initial term would be much more congruent with rural LEC investment cycles.

Rural LECs simply cannot acquire and construct new facilities as rapidly as their larger counterparts. Rather, the financing, acquisition and installation of such facilities can take several years. First, unlike the RBOCs and other larger carriers, most rural LECs lack the cash reserves to self-finance significant infrastructure upgrades, as well as ready access to major commercial banks, the stock and bond markets, and venture capital funds. Rather, rural LECs must finance infrastructure investments via the generally more lengthy process of obtaining loans from the Rural Utilities Service, the Rural Telephone Finance Cooperative, CoBank and small local banks. Second, small rural LECs seeking to upgrade one or two exchanges at widely separated intervals often do not get the same prompt attention or early delivery from equipment vendors as larger carriers with continuous equipment acquisition programs or with large orders. Interstate Telcom Group members frequently wait at least 4 to 12 months for vendor delivery of equipment. Third, small rural LECs do not have sufficient personnel to perform their own construction and installations, but rather must contract with outside construction firms and wait for them to schedule the work. Finally, in large portions of Minnesota, Wisconsin, Michigan, Iowa, South Dakota, Ohio and Montana, the outdoor construction season lasts only six months of the year.

Because it can take several years for a rural LEC to commence and complete a major upgrade, its incentive to undertake such a project will be reduced if the mechanism for recovering its investment costs has a term of only five years. The Interstate Telcom Group believes that an initial seven-year term for the MAG Plan would much better fit the typical rural LEC investment cycle, and that it would provide a much greater incentive for small rural LECs to make significant infrastructure investments. In this regard, it is notable that the Commission employed eight-year transition periods to phase in the original Universal Service Fund and the 25 percent interstate allocation factor. MTS and WATS Market Structure, 50 Fed. Reg. 939 (December 1984).

The Interstate Telcom Group believes that it is the intent of the MAG Plan that the Path A incentive mechanism and the Path B rate of return mechanism will remain in effect indefinitely after the end of the initial term (whether it is five years or seven years). LECs that elected to convert to Path A at or before the end of the initial term will remain on Path A unless and until the Commission modifies its interstate access mechanisms.

LECs that elected to remain on Path B throughout the initial term will remain on Path B unless and until the Commission modifies these same interstate access mechanisms.

The Commission can greatly enhance the certainty and stability produced by the MAG Plan by clarifying that it will keep the Path A and Path B mechanisms in place beyond the initial term as long as they are encouraging the continued provision of quality services to rural consumers. Should the Commission determine at any time after the initial term that technological or economic changes preclude the MAG Plan mechanisms from continuing to meet their goals, it could take the steps necessary to modify or supersede them.

The Interstate Telcom Group also believes that it is the intent of the MAG Plan that LECs be permitted to convert study areas to Path A incentive regulation at any time during the initial term. The Interstate Consulting Group believes that the flexibility to convert throughout the year (as opposed to limited conversion dates such as January 1 and/or July 1) will facilitate conversions for those carriers that elect Path A regulation.

Finally, the Interstate Telcom Group is concerned that the Commission may implement increases in subscriber line charges (SLCs) and offsetting decreases in carrier common line (CCL) charges as of July 1, 2001, but defer implementation of the major part of the MAG Plan until January 1, 2002 or thereafter. A rushed implementation of the SLC/CCL portion of the MAG Plan would cause administrative and customer relations difficulties for rural LECs, and could also cause financial disruptions for the industry if the SLC and CCL offsets did not match. It is better to wait until at least January 1, 2002 to implement SLC increases so that rural customers can be informed fully of the changes and so that better information can be employed to make the necessary CCL adjustments.

The Interstate Telcom Group does not agree that the SLCs of rural LECs should be increased to the same levels as those of the CALLS participants. In the minds of most customers, an increase in the SLC is equivalent in all relevant respects to an increase in local service rates. The local service rates of rural LECs have traditionally been lower than the local service rates of urban and suburban LECs because rural LEC customers have much smaller local calling areas and pay toll charges for many calls necessary to reach the closest businesses, government offices, schools, and hospitals. SLCs should also be priced on this basis, and remain lower in rural areas with small local calling areas.

No Productivity Offset Should Be Included In Path A

Rural and other small LECs electing incentive regulation do not possess the size or operating scale to support an annual productivity offset like that imposed upon the large price cap LECs. The Commission should not add an X-factor or consumer productivity dividend to the proposed Revenue Per Line (RPL) mechanism of Path A.

The typical Interstate Telecom Group member has a full-time staff of 2-to-12 employees, and some members have as few as two full-time employees. In contrast, the 1999 Annual Reports of Verizon and SBC indicate that they had 145,000 and 204,530 employees, respectively.

A large carrier like Verizon or SBC has significant economies of scale, and can readily increase productivity by measures such as increased specialization, consolidation of previously dispersed functions at a single office, reductions in force and sale of underperforming exchanges. In contrast, small rural LECs do not have similar capabilities or opportunities for productivity gains. How does a small rural LEC with a staff of 2-to-12 employees who perform multiple functions at a single office increase its productivity by a factor of 3, 5 or 7 percent per year for several years? All of the Interstate Telcom Group members have installed digital switches and many have in-house information systems. Consequently, these rural LECs have little room to increase productivity by replacing employees with automated functions.

As noted above, the Commission did not impose price cap regulation upon small and mid-sized LECs because it could not reasonably subject them to a regulatory regime based largely on the historical performance of the RBOCs and other large carriers. LEC Price Cap Order, supra. A primary aspect of this decision was the inapplicability of the X-factor to smaller carriers. The Commission has no reason to change this wise policy with respect to the RPL factor proposed in the MAG Plan.

A Low End Adjustment Is A Necessary
Safety Net For Small LECs Electing Path A Incentive Regulation

It is critical for small LECs electing Path A incentive regulation to have a safety net to preserve their ability to operate as their investments, revenues and/or expenses fluctuate significantly from time to time. The proposed Low End Adjustment (LEA) serves this function.

The Interstate Telcom Group recognizes that incentive regulation is supposed to be risky. However, the Commission must itself recognize that many rural LECs were the only entities showing any perceptible commitment to serve their areas during the 20th Century, and that many will continue in this role well into the 21st Century. The Commission must also recognize that substantial periodic investments in infrastructure, as well as uncontrollable events like severe storms and relocations of major customers, can result in crippling shortfalls in cash flow and/or earnings for small carriers from time to time.

Large LECs have the size, scale and resources to smooth their investment patterns by scheduling upgrades of specified portions of their exchanges each year, and to offset substantial expense increases in a few exchanges against the rest of their operations. In contrast, rural LECs need a safety net like the LEA if they are to support periodic infrastructure upgrades for one of more of their exchanges, and to offset and recover from uncontrollable expense increases that decrease their cash flow and/or earnings. The LEA will allow small LECs to remain stable in the face of these conditions without degrading the present service of the rural residents dependent on them or reducing the investments necessary to furnish new and quality services in the future.

<u>The Prescribed Rate of Return Should Remain At 11.25 Percent</u>

The Interstate Telcom Group supports the retention of a prescribed rate of return of 11.25 percent. The cost of capital and equity of rural LECs appears to have increased since this rate was established in 1990, and do not appear ready to decrease during the foreseeable future.

From 1995 to the present, the costs of capital and equity for rural LECs have increased due to the uncertainty regarding the future of the access charge revenues and universal service support that comprise the major portion of their revenue bases . A "sword of Damocles" has hung precariously over the rural telephone industry for over six years as the Commission has initiated or promised access reform, universal service, separations reform, rate represcription proceedings likely to significantly impact critical interstate access revenues and universal service support.

If and when they are adopted, the proposed MAG Plan and the Rural Task Force Recommendation will significantly reduce these regulatory uncertainties. However, for many rural LECs, there will still remain significant regulatory questions while their state commissions determine whether and how to respond to the federal changes.

More important, there has arisen increasing business and technological uncertainty as the telecommunications industry determines when and how to respond to the "Digital Broadband Migration" and related technology changes. Rural LECs and their investors and lenders are asking many questions, including:

1. Will their rural customers take broadband services today in sufficient amounts and at sufficient prices to render the investment necessary for their introduction financially viable at this time?
2. Will broadband deployment in urban areas require broadband deployment in rural areas at an early date for compatibility reasons (e.g., will non-broadband equipment continue to be manufactured and sold once the large carriers and urban areas convert to broadband)?
3. Will the cost of broadband deployment decrease significantly during coming years, and can rural LECs wait for these cost decreases before deploying in their areas?
4. Will low earth orbiting (LEO) satellites or yet-to-be-developed future technologies bring significant competition to rural areas?

These and similar unanswered questions highlight the fact that the rural LEC industry will continue to be faced with much uncertainty, even after the Commission reduces the regulatory uncertainties of the last six years. These new business and technological uncertainties mean that business risks and the cost of capital and equity for rural LECs will continue to be at least as great as they were in 1990, and that the prescribed rate of return should remain at 11.25 percent.

Conclusion

The Interstate Telcom Group generally supports the interstate access reform proposals set forth in the MAG Plan. They provide the certainty and flexibility essential for rural LECs to continue serving the rural areas dependent on them and to bring new advanced services to these areas at a feasible date. The MAG Plan properly recognizes both the differences between large and small LECs and the differences among small LECs themselves, and proposes a flexible multi-path solution that will serve rural residents without adversely impacting the interexchange industry. The Interstate Telcom Group will continue to support the MAG Plan so long as it retains the Path B rate of return option, provides a sufficient and flexible transition for rural LECs electing Path A incentive regulation, rejects the imposition of a productivity offset upon the Path A formula, includes a Low End Adjustment mechanism for small LECs, and retains the current prescribed 11.25 percent rate of return.

Respectfully submitted,
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Dated: February 26, 2001

CERTIFICATE OF SERVICE

I, Douglas W. Everette, hereby certify that I am an attorney with the law firm of Blooston, Mordkofsky, Dickens, Duffy & Prendergast, and that a copy of the foregoing **Comments of The Interstate Telcom Group** concerning the proposals of the Multi-Association Group to be served by first class mail or hand delivery this 26th day of February, 2001, to the persons listed below.

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