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Federal-State Joint Board on Universal Service )  
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CC Docket No. 96-45

**COMMENTS OF INNOVATIVE TELEPHONE  
(FORMERLY KNOWN AS THE VIRGIN ISLANDS TELEPHONE CORPORATION)**

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## SUMMARY

Innovative Telephone applauds the efforts of the Rural Task Force (“RTF”), the Federal-State Joint Board on Universal Service (“Joint Board”), and the Commission to develop an appropriate mechanism to provide universal service support to rural and insular carriers. The RTF’s recommendations are the result of careful deliberations that considered the views of representatives from state public utility commissions, state consumer advocates, local exchange carriers, long distance carriers, competitive local exchange carriers, a wireless carrier, and the Rural Utilities Service (“RUS”). The Joint Board has endorsed the RTF’s proposals and recommends that the Commission adopt them in their entirety. Although these recommendations are not all that Innovative Telephone feels is warranted, on balance, the RTF’s proposed mechanism is far better than the existing system, which fails to satisfy the statutory requirement of Section 254 of the Communications Act to provide “sufficient” support. Thus, Innovative Telephone urges the Commission to take expedient action on the Joint Board’s recommendations to ensure that all Americans, no matter where they live, continue to enjoy access to affordable, reliable, and modern telecommunications services.

**Insular Differences Matter.** In Section 254(b), Congress specifically provided that the universal service mechanism should provide support to rural, *insular* and high-cost areas. By including each of these categories separately, Congress required that no region would be permitted to fall through the cracks of the new law. The Commission, Joint Board, and the RTF all recognize that the Act requires the unique status of insular carriers to be explicitly addressed.

Insular areas *are* different. The RTF found that insular carriers face higher costs to build and maintain plant, higher labor costs, increased costs of project management, and higher

operational costs. This conclusion is supported by a special report by Dr. Kenneth Gordon which found that geographic isolation of insular areas, and their topography and geology, combine to increase costs.

The geographic isolation of insular areas leads to much higher unit transportation costs than similar mainland communities experience. The small size of insular economies limits both the available production capacity and the market available to local businesses, and also precludes the benefits of economies of scale. Additionally, while tropical climates appear to be a paradise to some, that is not the case for providers of telecommunications services. Carriers must overcome a rough, rugged terrain, a warm, moist tropical climate, a high level of corrosive airborne salt, and very destructive weather patterns. Moreover, the same conditions that make providing telecommunications expensive, also combine to create generally difficult economic conditions. The bottom line is that the unique geographical, geological, and climatological conditions found in insular areas causes carriers in these areas to experience higher costs than carriers on the mainland. These costs and economic factors combine to yield a telephone penetration rate in the U.S. Virgin Islands substantially lower than that of the rest of the country.

**Universal Service Support for Catastrophic Events Must Be Continued.** At present, carriers can recover costs incurred as the result of catastrophic events, such as extraordinary natural disasters, through the universal service mechanism. The RTF has provided for continuing universal service support in such circumstances by recommending an adjustment to its proposed “freeze” on per-loop support, which would allow rural and insular carriers to recover costs of catastrophic events affecting their ability to provide universal service. Innovative Telephone strongly supports this proposed adjustment, which maintains the *status quo* and

ensures that consumers in areas devastated by natural disasters will not also suffer the burden of dramatic increases in the cost of local telephone service.

The narrow catastrophic event provision will not affect carriers' need to also obtain private insurance to cover damages resulting from catastrophic events. Nor would the provision allow any "double recovery"; rather, rural and insular carriers would be permitted under the exception to recover universal service support only for costs *not* reimbursed by a carrier's insurer. Further, the other potential sources of funds in the event of natural disasters contemplated in the Further Notice of Proposed Rulemaking – Rural Utility Service loans and federal and state emergency relief – provide no alternative to continued universal service support. The former merely is a source of financing that must be repaid, not a source of funds; and federal and state emergency relief is generally not available to for-profit business entities. In any event, even if some form of emergency relief were available to insular and rural carriers, the catastrophic event provision would only permit recovery of costs *not* recovered from these (or any other) sources.

**The Reform of Existing Limits on Support Is Required.** The Commission has an obligation to eliminate or reform the policies that arbitrarily limit the size of the universal service fund or restrict the ability of insular and rural carriers to recover the costs of providing service. Although the rationale for caps on universal service support cannot be found in the express language of Section 254, Innovative Telephone recognizes that they are a necessary policy compromise and thus supports caps that are rational and reasonable, such as those proposed by the RTF. In particular, although Innovative Telephone strongly believes that eliminating the cap on the support that a carrier receives on lines it obtains through merger and other types of

acquisition would be good public policy and would be consistent with the mandate of Section 254 to provide “sufficient” support, it is willing to support the RTF’s compromise recommendation that the existing cap be modified to allow insular and rural carriers to recover a portion of their meaningful investments in infrastructure.

In the event that the aggregate cap on “safety valve” support is exceeded in any given year, carriers should receive support under this mechanism on a *pro rata* basis. The Commission should set the aggregate cap at a level that is sufficiently high that it will not undermine the statutory goal of preserving and advancing universal service. Further, the Commission should adopt the definition of “meaningful investment” formulated by the RTF, to avoid the problems associated with differing accounting methods that may be employed by the selling and acquiring carriers. Finally, the Commission should not attempt at this stage to deviate from the compromise solution developed by the RTF by extending the proposed “freeze” of per-loop support to the “safety valve” mechanism in competitive study areas. Instead, it should adopt the delicately-crafted compromise package in its entirety, as recommended by the Joint Board.

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

\_\_\_\_\_ )  
Federal-State Joint Board on Universal Service ) CC Docket No. 96-45  
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**COMMENTS OF INNOVATIVE TELEPHONE**

Innovative Telephone (formerly known as the Virgin Islands Telephone Corporation),<sup>1</sup> by its attorneys, hereby submits these comments in response to the Commission's *Further Notice of Proposed Rulemaking* ("FNPRM") released on January 12, 2001, and published in the Federal Register on January 26, 2001.<sup>2</sup> The FNPRM seeks comments on the *Recommended Decision* of the Joint Board,<sup>3</sup> which recommends that the Commission adopt the *Rural Task Force Recommendation* ("RTF Recommendation")<sup>4</sup> regarding the implementation of a universal service plan for rural and insular carriers.

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<sup>1</sup> The Virgin Islands Telephone Corporation is doing business under the trade name "Innovative Telephone."

<sup>2</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Further Notice of Proposed Rulemaking, FCC 01-8 (rel. Jan. 12, 2001) ("FNPRM"), summarized at 66 Fed. Reg. 7867 (proposed Jan. 26, 2001).

<sup>3</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, FCC 00J-4 (rel. Dec. 22, 2000) ("Recommended Decision").

<sup>4</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service (rel. Sept. 29, 2000) ("RTF Recommendation").

Innovative Telephone applauds the efforts of the RTF, the Joint Board, and the Commission to create a plan that strikes a reasonable compromise for providing rural and insular carriers with specific, predictable, and sufficient universal service support for an interim period of five years. Innovative Telephone urges the Commission to take expedient action to adopt the *Recommended Decision*. The existing system of support simply does not satisfy the statutory requirements of Section 254 of the Communications Act to provide “sufficient” support. Therefore, immediate action is required to ensure that all Americans, no matter where they live, will continue to enjoy access to affordable, reliable, and modern telecommunications services.

## **I. INTRODUCTION**

The RTF was formed by the Joint Board to examine the issue of universal service support to carriers serving rural and insular areas. It was specifically tasked to present to the Joint Board recommendations on the appropriate mechanism to be used in reforming universal service support for rural carriers. With considerable foresight, RTF membership included representatives from state public utility commissions, state consumer advocates, local exchange carriers, long distance carriers, competitive local exchange carriers, a wireless carrier, and the RUS. In this way, the Joint Board guaranteed that RTF deliberations would consider all points of view. Additionally, such membership ensures that any recommendations coming out of this body reflect a broad consensus.

Innovative Telephone is encouraged by the work of the RTF. This group has constructed “a delicately-crafted package”<sup>5</sup> that carefully considers the interests of a very diverse body of interested parties. The RTF engaged in considerable deliberations and significant study (including the publication of several white papers on key universal service issues). After careful review, the Joint Board has now recommended that the Commission adopt the RTF recommendations in their entirety.<sup>6</sup>

Although they are not all that Innovative Telephone feels is warranted, on balance, the recommendations are better than the existing system and should be adopted by the Commission. There are serious problems with the existing mechanism of supporting the provisioning of telecommunications services to customers in high cost rural and insular areas. These problems undermine the ability of carriers to provide services and fail to satisfy the statutory mandate to provide “sufficient” universal service support. Current policy, contrary to Section 254, places undue weight on limiting the amount of universal service support through caps and other mechanisms. For example, the “merger and acquisition cap” prevents carriers from recovering their investments in infrastructure following a merger or acquisition to the extent that per-line support for the acquired lines would exceed the prior owner’s level of support. This rule arbitrarily discourages investments in infrastructure that are badly needed in insular and rural areas. Also, counter to the statute, the existing mechanism treats rural and insular carriers, in many respects, like non-rural carriers. Such limits have profound negative effects on insular and rural carriers.

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<sup>5</sup> *RTF Recommendation* at 3.

<sup>6</sup> *See Recommended Decision* at ¶ 22.

For the reasons discussed below, Innovative Telephone urges the Commission to move quickly to adopt the recommendations of the RTF and the Joint Board.

## **II. THE ACT INTENDED THAT INSULAR AREAS RECEIVE SPECIAL TREATMENT REGARDLESS OF THE RURAL OR HIGH COST NATURE OF THE INSULAR AREA**

### **A. Section 254(b) Specifically Charges the Commission with Ensuring that Americans in Rural, High Cost and Insular Areas Enjoy Universal Services.**

When it enacted the 1996 Act, Congress included Section 254(a)(1), which “directed the Commission to establish support mechanisms for the preservation and advancement of universal service in the competitive telecommunications environment that Congress envisioned.”<sup>7</sup> In Section 254(b), Congress specifically provided that the universal service mechanism should provide reasonably comparable rates in “rural, *insular* and high-cost” areas.<sup>8</sup> By including each of these categories separately, Congress was acting to ensure that no region fell through the cracks of the new law. Congress’ addition of “insular” to the list of categories in the statute clearly indicates that the unique characteristics of insular regions should be recognized irrespective of those regions’ high-cost or rural status. As a matter of statutory construction, the use of different terms in the statute makes clear Congress intended that the Commission specifically address universal service protections for insular areas separate and apart from those that are applicable to other high-cost areas. As courts have noted, “[w]here different terms are

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<sup>7</sup> *Federal-State Joint Board on Universal Service*, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20442 (1999) (“*Ninth Report and Order*”).

<sup>8</sup> 47 U.S.C. § 254(b)(3) (emphasis added). The conference report accompanying the 1996 Act reveals that Congress deliberately extended universal service support to insular areas to provide consumers in such areas “access to telecommunications and information services.” H.R. Conf. Rep. No. 104-458, at 131 (1996), *reprinted in* 1996 U.S.C.C.A.N. 124, 142.

used in a single piece of legislation, the court must presume that Congress intended the terms to have different meanings.”<sup>9</sup> Although agencies have great discretion in interpreting statutory text, they may not disregard the intent of Congress. “If the intent of Congress is clear, that is the end of the matter.”<sup>10</sup>

Here, both the language of Section 254 and the legislative history clearly indicate that Congress intended the Commission to recognize that insular areas are subject to their own set of unique challenges when it comes to the provision of universal telecommunications service. Indeed, in 1996, the Joint Board issued a recommended decision that identified this need to accord special attention to the circumstances of insular carriers. That decision “recognize[d] the special circumstances faced by carriers and consumers in the insular areas of the United States.”<sup>11</sup> As a result, the Joint Board advised that the Commission adopt an approach, different from that used in other areas, whereby “rural carriers serving high cost insular areas . . . should continue to receive universal service support based on their embedded costs.”<sup>12</sup>

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<sup>9</sup> *Transbrasil S.A. Linhas Aereas v. Dep’t of Transp.*, 791 F.2d 202, 205 (D.C. Cir. 1986) (quoting *Wilson v. Turnage*, 750 F.2d 1086, 1091 (D.C. Cir. 1984), *vacated on other grounds*, 755 F.2d 967 (D.C. Cir. 1985)).

<sup>10</sup> *Chevron, U.S.A., Inc. v. Natural Resources Def. Council*, 467 U.S. 837, 842 (1984).

<sup>11</sup> *Federal-State Joint Board on Universal Service*, Recommended Decision, 12 FCC Rcd 87, 308 (1996).

<sup>12</sup> *Id.* To date, the Commission has not acted upon this unanimous recommendation of the Joint Board.

**B. The Federal-State Joint Board Recommended that Insular Carriers Be Accorded a Special Status Because of Their Insular Status.**

The RTF recognized that the 1996 Act requires the unique status of insular carriers to be explicitly addressed by the Joint Board and the Commission.<sup>13</sup> Although primarily focused on identifying the necessary distinction between universal service support for rural and non-rural carriers, the RTF also found that insular carriers face higher costs to build and maintain plant, higher labor costs, increased costs of project management, and higher operational costs.<sup>14</sup> The RTF specifically recognized that insular carriers “experience difficulty and high cost in moving personnel, equipment and supplies to remote and insular communities.”<sup>15</sup> Further, its recognition that coral and volcanic rock surface conditions “require expensive specialized outside plant construction practices” is attributable to the geographic conditions facing insular, as opposed to non-insular rural, carriers.<sup>16</sup> Additionally, the RTF recognized that the inhospitable weather conditions – particularly frequent tropical storms and hurricanes – raise both construction and operations costs.<sup>17</sup> In particular, the RTF commented that “[r]ecent experience with hurricanes in the Virgin Islands seems to indicate that with the current frequency of these severe natural disasters, plant service lives may be better measured in months instead of years.”<sup>18</sup> In sum, it

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<sup>13</sup> See, e.g., *RTF Recommendation* at 5-7, 14.

<sup>14</sup> See Rural Task Force, *White Paper 2: The Rural Difference*, 26-29 (Jan. 2000) (“*The Rural Difference*”), available at <http://www.wutc.wa.gov/rtf>.

<sup>15</sup> *RTF Recommendation* at 12.

<sup>16</sup> *Id.*

<sup>17</sup> See *The Rural Difference* at 29.

<sup>18</sup> *Id.*

recognized, like Congress and the Commission before it, that “‘rural telephone companies’ . . . including carriers serving insular areas, are different in terms of the costs they face and the territories they serve,” and thus the universal service support must be carefully tailored to address the special circumstances of rural *and insular* carriers.<sup>19</sup>

Accordingly, the Commission should follow the RTF’s *Recommendation* and adopt a universal service fund (“USF”) methodology that distinguishes insular carriers, such as Innovative Telephone, from other carriers that are dissimilarly situated. Innovative Telephone urges the Commission to: (1) recognize the special status of insular carriers, as required by Section 254, and (2) adopt a USF methodology that will permit the federal government to provide *full and sufficient* support to fund universal service in insular areas.

### **III. INSULAR AREAS EXPERIENCE UNIQUE CHALLENGES TO PROVIDING UNIVERSAL SERVICE**

Evidence other than that presented in the RTF white papers supports the unique challenges in serving insular areas. Carriers serving insular areas face circumstances that have the effect of driving up their costs of providing services to customers. These characteristics are directly tied to the very nature of insular areas – their geographic isolation and their topography and geology. Dr. Kenneth Gordon, Vice President of National Economic Research Associates, Inc. (“NERA”) and former Chairman of the Massachusetts Department of Public Utilities and the Maine Public Utilities Commission, has prepared comments that describe in detail insular carrier

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<sup>19</sup> *Id.* at 5; *see also RTF Recommendation* at 12.

service issues. Dr. Gordon's comments provide empirical support for Innovative Telephone's comments and are discussed below and included with this filing as Appendix A.<sup>20</sup>

**A. Insular Areas Are Isolated Geographically, Which Makes Costs Higher.**

The geographic isolation of insular areas is a significant factor that causes carriers in insular areas to experience far higher costs than carriers in the continental United States. As Dr. Gordon fully explores in his comments, there are several economic reasons for this higher cost burden on insular carriers: (1) higher unit transport costs; (2) higher costs arising from the small size of insular economies; and (3) the economic impact of geographic isolation on the cost of providing, operating, and maintaining telecommunications systems.

**1. Higher Unit Transport Costs.**

Island communities suffer from much higher unit transport costs than similar communities located on the mainland.<sup>21</sup> These higher transport costs, in turn, are attributable to three primary factors: (a) remoteness; (b) the imbalance of trade; and (c) the lack of economies of scale.

- **Remoteness:** Transport costs increase rapidly the farther an island is from the mainland because of the increased distance that material must be transported either by sea or air.<sup>22</sup> The U.S. Virgin Islands are located in the middle of the Caribbean Sea, 1,200 miles distant from the coast of Florida. This long distance, combined with "less advanced and more uncertain

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<sup>20</sup> See Comments of Dr. Kenneth Gordon, CC Docket No. 96-45 (filed Dec. 17, 1999) ("Gordon Comments") (attached as Appendix A).

<sup>21</sup> See *id.* at 4-6.

<sup>22</sup> See *id.* at 6.

regular transport technologies” between the mainland and the U.S. Virgin Islands, lead to high transport costs and increased likelihood of delays, which further add to costs.<sup>23</sup>

- **Imbalance of Trade:** Transport costs to insular communities are also increased by the fact that these communities are net importers of goods, which causes an imbalance between the inbound and outbound movements of goods. The under-utilization of outbound transport from island communities has a deleterious impact on the unit costs for inbound flows. “The end result is higher unit transport costs because[,] since containers often leave with few goods[,] the high opportunity costs of such trips will be reflected in higher inbound unit freight rates.”<sup>24</sup>

- **Lack of Economies of Scale:** Furthermore, because of their size and concurrent small market sizes, small islands simply do not import or export sufficient volumes of goods to achieve economies of scale. As a result, unit transport costs are high. In addition, island communities are too small to take advantage of advances in bulk cargo carriage (such as the development of larger aircraft and container ships) that have led to reductions in freight costs on other, more heavily trafficked, routes.<sup>25</sup> As Dr. Gordon notes, “newer transport technologies that make it possible to transport greater volumes of goods . . . have marginalized small island economies because these economies are too small to justify the high start-up costs involved with using these newer technologies.”<sup>26</sup>

The impact of high unit transport costs on the U.S. Virgin Islands is substantial: A review of Innovative Telephone work orders shows that every dollar of material used in

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<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 5.

<sup>25</sup> *See id.* at 4-5.

<sup>26</sup> *Id.* at 5.

operations incurs a transportation cost of \$1.10, which more than doubles the effective cost of the equipment.<sup>27</sup>

## 2. Higher Costs Arising from the Small Size of Insular Economies.

The small size of insular economies limits both the available production capacity and the market available to local businesses for their services. The result is that these economies are too small to be self-sustaining and are dependent upon the import of resources from the continental United States. Furthermore, insular economies are too small to achieve economies of scale, which results in higher costs.

- ***Non-Self-Sustaining Economies.*** Island economies are too small to allow specialized production of the wide range of goods necessary to meet demand. As a result, they must import a vast range of raw and finished materials, as well as specialized labor, that the community is too small to maintain or provide itself.<sup>28</sup> As described above, this entails significant transportation costs, raising the cost of many goods to businesses operating in insular markets. Thus, the costs of even the most essential and basic of items is driven up. These higher costs ripple through the economy as the imported, expensive raw materials are converted into finished goods. Moreover, the lack of specialized skilled labor requires businesses to import trained personnel from the mainland, and to compete for these personnel with businesses elsewhere in the United States.<sup>29</sup>

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<sup>27</sup> See *id.* at 18.

<sup>28</sup> See *id.* at 3-4.

<sup>29</sup> See *id.* at 7.

The U.S. Virgin Islands community is a prototypical example of a small, isolated non-self-sustaining island community. The entire Islands' population is less than 120,000 people.<sup>30</sup> The Islands lack their own industrial and agricultural bases.<sup>31</sup> The largest industry in the country is tourism, which accounts for over 70% of the territory's GDP. Given the prominence of the tourist industry and the concurrent lack of others, the U.S. Virgin Islands must import the lion's share of the goods that it uses every year. As a result, the islands suffer from an annual \$400 million trade deficit with the mainland. The increased costs of transportation are reflected in the U.S. Virgin Islands' cost of living, which is 30% higher than on the mainland.

- ***Absence of Economies of Scale.*** The limited size of insular markets “prevents firms from capturing economies of scale associated with increases in production and thus negatively affects how cheaply goods and services can be produced.”<sup>32</sup> This increases the cost of transporting goods and services *within* island communities.<sup>33</sup> Moreover, because of the lack of local demand, infrastructure projects are more costly, often rendering them uneconomical.<sup>34</sup> This leads to reduced levels of investment in infrastructure, which further raises unit costs and hampers economic growth.<sup>35</sup> The U.S. Virgin Islands is no exception; it suffers from an

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<sup>30</sup> See A Report on the State of the Islands 1999, U.S. Department of the Interior, Office of Insular Affairs, 46 (1999) (“*Insular Affairs Report*”).

<sup>31</sup> Total employment in manufacturing was only 2,210 in 1997. *See id.* Even this number is misleading, as many of the jobs in this sector are in export industries such as watch assembly and oil refining. In 1995, the last year for which data is available for agriculture, that sector employed a mere 3,110 of the 45,010 total workforce members. *See id.* at 54.

<sup>32</sup> Gordon Comments at 4.

<sup>33</sup> *See id.* at 6.

<sup>34</sup> *See id.*

<sup>35</sup> *See id.*

infrastructure that is “not fully developed and is poor in quality” and limits even the ability to provide basic needs such as water and electricity to the Islands’ population.<sup>36</sup>

### 3. The Impact of Geographic Isolation on Telecommunications Systems.

The geographic isolation of insular areas serves to increase the difficulties and cost of providing telecommunications systems, in particular. In the event of an emergency, it is difficult or impossible to rely on rapid importation of spare parts or specialized personnel. For example, even under the best circumstances none of the major shipping firms can offer guaranteed overnight service to the U.S. Virgin Islands. During a crisis, when the airport may be closed, delivery times can stretch from many days to even weeks. As a result, insular telephone carriers must stock substantially higher numbers of spares than a rural telephone carrier on the mainland.<sup>37</sup> The same holds true for repair personnel, who cannot easily be brought in from surrounding communities in times of need.<sup>38</sup> The cost of sustaining the necessary extra personnel and inventory is quite significant, which drives up operating costs substantially.

Furthermore, an insular carrier must be prepared to compensate for failures in other areas of infrastructure, as well. For instance, whereas a mainland telephone carrier may rely on a certain standard of electrical service and only need to provide backup power for a limited time, an insular carrier is often confronted with electrical service that is far less reliable. This

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<sup>36</sup> *Id.*

<sup>37</sup> *See id.* at 21.

<sup>38</sup> *See id.*

translates into a need for greater redundancy in backup systems, as well as a need for a longer-term operating capability for backup systems.<sup>39</sup> Both of these requirements increase costs.

Finally, in the particular case of the U.S. Virgin Islands, the population is spread between four small islands, separated by forty miles of ocean. Thus, in order to provide service to all of its customers, Innovative Telephone must use a far more elaborate network than would be required in a mainland community of 120,000 people.

**B. Unique Geography and Weather Make It Much More Difficult To Provide Reliable Telephone Service in Insular Areas.**

While insular areas in tropic climates might be perceived as a kind of paradise, the reality for telecommunications service is very different. Insular areas, such as the U.S. Virgin Islands, are often formed as the result of volcanic activity, which leads to rough, rugged terrain composed mainly of volcanic rock, with extreme elevation changes over very short distances.<sup>40</sup> The warm, moist tropical climate leads to an enhanced need for environmental protection for telecommunications equipment and infrastructure. Exacerbating this problem is the high level of airborne salt, which perpetually blows in from the surrounding ocean and causes rapid corrosion of plant.

In addition, many insular areas lie in the path of very severe weather patterns. The U.S. Virgin Islands are no exception. The territory's location in the Caribbean means that it is

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<sup>39</sup> See *id.* at 6-7.

<sup>40</sup> See *id.* at 9.

frequently hit by hurricanes,<sup>41</sup> which can rapidly and unexpectedly destroy large amounts of the Islands' infrastructure.<sup>42</sup> In fact, in 1999, the Islands suffered a direct hit from Hurricane Lenny, which caused very substantial damage on the island of St. Croix.<sup>43</sup> Hurricane Lenny is the fifth hurricane to smash into the islands in the past twelve years.<sup>44</sup> These severe weather conditions led the RTF to conclude that "[r]ecent experience with hurricanes in the Virgin Islands seems to

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<sup>41</sup> NOAA has estimated that, in any given year, there is a greater than 50% probability that the U.S. Virgin Islands will be hit by a hurricane or tropical storm. See Christopher W. Landsea, Hurricane Research Div., Atlantic Oceanographic & Meteorological Lab., Nat'l Oceanic & Atmospheric Administration ("NOAA"), *FAQ: Hurricanes, Typhoons and Tropical Cyclones: Part G: Tropical Cyclone Climatology*, at <http://www.aoml.noaa.gov/hrd/tcfaq/tcfaqG.html#G12> (Aug. 9, 2000).

<sup>42</sup> When Hurricane Marilyn hit the Virgin Islands in 1995, the Islands encountered maximum sustained winds of 102 mph, which destroyed an estimated 80% of the homes and businesses on St. Thomas and left at least 10,000 people homeless. See Edward N. Rappaport, Nat'l Hurricane Ctr., Nat'l Weather Serv., NOAA, *Preliminary Report on Hurricane Marilyn*, at <http://www.nhc.noaa.gov/1995marilyn.html> (last updated Jan. 17, 1996). Approximately 30% of the houses on St. John were destroyed, and 20-30% of the houses on St. Croix were damaged. See *id.* The U.S. Department of Interior has reported that the combined economic costs to the Virgin Islands of Hurricanes Marilyn and Hugo (which hit the islands in 1989) is in the range of \$3-4 billion. See *Insular Affairs Report* at 46.

<sup>43</sup> Hurricane Lenny, a category 4 storm, slammed into St. Croix on November 16-17, 1999. Damages from this storm have been estimated at \$165 million for Puerto Rico and the U.S. Virgin Islands. See John L. Guiney, Nat'l Hurricane Ctr., Nat'l Weather Serv., NOAA, *Preliminary Report on Hurricane Lenny*, at <http://www.nhc.noaa.gov/1999lenny.html> (last modified Mar. 31, 2000).

<sup>44</sup> Following Hurricanes Hugo and Marilyn, see *supra* note 42, the Virgin Islands were hit in July 1996 by Hurricane Bertha, which damaged almost 2500 homes on St. Thomas and St. John. See Miles B. Lawrence, Nat'l Hurricane Ctr., Nat'l Weather Serv., NOAA, *Preliminary Report on Hurricane Bertha*, at <http://www.nhc.noaa.gov/1996bertha.html> (Nov. 9, 1996). Two years later, Hurricane Georges caused an additional \$50 million in damage to the Islands. See John L. Guiney, Nat'l Hurricane Ctr., Nat'l Weather Serv., NOAA, *Preliminary Report on Hurricane Georges*, at <http://www.nhc.noaa.gov/1998georges.html> (Jan. 5, 1999). The most recent event was Hurricane Lenny. See *supra* note 43.

indicate that with the current frequency of these severe natural disasters, plant service lives may be better measured in months instead of years.”<sup>45</sup>

The telecommunications infrastructure in the U.S. Virgin Islands is especially vulnerable because the rocky make-up of the ground generally makes the use of underground or buried cable prohibitively expensive. A large amount of resources must be devoted to repairing and rebuilding the communications network when it suffers damage from these storms, which can happen with alarming frequency.

The outcome of the unique geographical, geological, and climatological conditions that exist in insular areas is that carriers in these areas experience higher costs than carriers on the mainland. Consequently, consumers in insular areas face higher rates than consumers in urban or rural areas on the mainland, even under the existing universal service structure. Customers in the U.S. Virgin Islands pay rates that are substantially higher than the U.S. average: residential rates average \$18.55, which is 61% higher than the average U.S. figure for rural rates (\$11.51),<sup>46</sup> and 31% higher than the U.S. average urban rate (\$14.20).<sup>47</sup> Business rates are also high. The business line flat fee in the U.S. Virgin Islands is \$49.85, which is more than double the U.S. average for rural rates (\$21.72)<sup>48</sup> and 42% higher than the U.S. average for urban rates (\$34.88).<sup>49</sup>

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<sup>45</sup> *The Rural Difference* at 29.

<sup>46</sup> *See Common Carrier Bureau, FCC, Reference Book of Rates, Price Indices and Expenditures for Telephone Service* at 36 (June 1999).

<sup>47</sup> *See id.* at 3.

<sup>48</sup> *See id.* at 36.

<sup>49</sup> *See id.* at 16.

**C. Insular Economies Remain Fragile Despite Favorable Economic Conditions in the Continental United States.**

The rugged terrain, small land mass, difficult weather, and substantial physical isolation that characterize many insular communities can combine to create very difficult economic conditions. Nowhere is this more true than the U.S. Virgin Islands. Because of the geography of the islands, agriculture is difficult and the long distance to the mainland make the islands an unattractive location for industry.

As noted above, 70% of the economic activity in the U.S. Virgin Islands comes from tourism, which results in relatively low-paying service jobs. The impact of this situation is reflected by the fact that nearly a third of the Islands' population live below the poverty line.<sup>50</sup> Even those earning above the poverty line are impacted by the high cost of living. The per capita income is only approximately \$12,000, which is only 80% of the average per capita income of the U.S. mainland.<sup>51</sup>

These economic conditions exist despite a decade of economic prosperity in most of the United States. While the mainland economy has grown at a healthy rate over the past ten years, “[t]hroughout the 1990s, the Virgin Islands economy has been nearly stagnant.”<sup>52</sup> The string of hurricanes that have hit the Islands, coupled with other factors, have had a substantial impact on an already struggling economy. Dr. Gordon reports: “Even tourism – one of the main industries in the Virgin Islands – has fared poorly in the last six years. The civilian labor force, income tax

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<sup>50</sup> Approximately 30% of the Islands' population is below the poverty line. *See Insular Affairs Report* at 46. In the mainland U.S., less than 14% of the population lives below the poverty line.

<sup>51</sup> *See id.*

<sup>52</sup> Gordon Comments at 11.

receipts, the number of tourists, cruise ships, occupancy rates in hotels, the number of hotels, and the total expenditures by tourists have all actually dropped during the last six years.”<sup>53</sup> The economic boom enjoyed on the mainland never reached the Virgin Islands, and is not likely to reach it in the foreseeable future.

**D. As a Result of High Costs and Depressed Economic Conditions, Insular Areas Suffer from Low Telephone Penetration Rates.**

The conditions that are created by the characteristics of insular areas are not without their effects. These economic factors combine to yield a telephone penetration rate in the U.S. Virgin Islands of only 88%, as compared to a rate of more than 94% in the United States as a whole.<sup>54</sup> The Commission has noted that “subscriberhip levels provide relevant information regarding whether consumers have the means to subscribe to universal service and, thus, represent an important tool in evaluating the affordability of rates,”<sup>55</sup> and that low penetration rates in these areas are largely the result of “income disparity, compounded by the unique challenges these areas face by virtue of their location.”<sup>56</sup> In the case of the U.S. Virgin Islands, the low

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<sup>53</sup> *Id.*

<sup>54</sup> In 1995, the Virgin Islands Public Services Commission (“VIPSC”) reported that the penetration rate for telephone service in the territory was 87.8%. *See* Letter from Maria Tankenson Hodge, Legal Counsel of VIPSC, to the FCC (Oct. 12, 1995). No more recent data is available, but based on its own investigation and estimates Vitelco believes that this penetration rate remains accurate today. The penetration rate for the U.S. was 93.9% in 1995, and 94.4% in July 2000, the most recent month for which data are available. *See* Alexander Belinfante, Industry Analysis Div., FCC, *Telephone Subscriberhip in the United States*, at 17, 20 (Dec. 2000).

<sup>55</sup> *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8838 (1997) (“*Universal Service Order*”).

<sup>56</sup> *Federal-State Joint Board on Universal Service: Promoting Deployment and Subscriberhip in Unserved and Underserved Areas, Including Tribal and Insular Areas*, Further Notice of Proposed Rulemaking, 14 FCC Rcd 21177, 21181 n.23 (1999).

subscriber rates indicate that the local economy is simply not robust enough to prevent a large number of island residents from having to forgo basic telephone service if rates were to increase.

**IV. THE JOINT BOARD'S RECOMMENDED DECISION IS CONSISTENT WITH SECTION 254 AND SHOULD BE ADOPTED BY THE COMMISSION IN ITS ENTIRETY**

The Joint Board recommends that the Commission adopt the terms of the *RTF Recommendation* in its entirety. The Joint Board asserts that the *RTF Recommendation* serves as a “good foundation for implementing a rural universal service plan that benefits consumers.”<sup>57</sup> Furthermore, it agrees with the RTF that the *Recommendation* is consistent with the mandate of Section 254, which directs the Commission to adopt “specific, predictable and sufficient” mechanisms to preserve and advance universal service.<sup>58</sup> Based on these findings, the Joint Board concludes that the *RTF Recommendation*, which reflects the compromise reached by the various constituencies affected by universal service reform, should be adopted without exception.<sup>59</sup> Innovative Telephone supports this eminently reasonable position. The *RTF Recommendation* provides an interim universal service solution that will facilitate competition in rural and insular areas while complying with the mandates of Section 254.

The Joint Board has suggested that the Commission seek public comments on a number of specific details relating to the implementation of the *RTF Recommendation*.<sup>60</sup> Accordingly, in

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<sup>57</sup> *Recommended Decision* at ¶ 1.

<sup>58</sup> 47 U.S.C. § 254(b)(5), (d); *see also Recommended Decision* at ¶ 1.

<sup>59</sup> *See Recommended Decision* at ¶ 22.

<sup>60</sup> *See id.* at ¶ 14.

the *FNPRM*, the Commission requests comments on a small number of implementation issues.<sup>61</sup> Innovative Telephone addresses two of these specific issues below: (1) the importance of continuing to allow rural and insular carriers to recover costs caused by catastrophic events; and (2) the reasonableness of the proposed “safety valve” mechanism, which will allow rural and insular carriers to recover a portion of their meaningful investments in infrastructure subsequent to mergers or acquisitions.

**A. The Proposed Adjustment to Frozen Loop Costs for Catastrophic Events Is Necessary to Ensure Sufficient Universal Service Support for Rural and Insular Carriers.**

The RTF has proposed that universal service support per loop should be frozen in study areas where a competitive eligible telecommunications carriers (“CETC”) has been approved and is providing service.<sup>62</sup> Notably, the *RTF Recommendation* provides, however, that “an ILEC may adjust frozen per loop support to recover costs of catastrophic events affecting the ability of [eligible telecommunications carriers (“ETCs”)] to provide universal service.”<sup>63</sup> This exception ensures that rural and insular carriers will be able to recover the costs associated with extraordinary natural disasters that would otherwise directly impact the ability of these carriers to provide universal service.

The Joint Board has recommended adoption of the general rule freezing per loop support when a CETC begins providing services in a given study area.<sup>64</sup> Further, it has suggested that the Commission “should seek further input on the impact of ‘catastrophic event’ support provided by

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<sup>61</sup> See *FNPRM* at ¶¶ 5-7.

<sup>62</sup> See *RTF Recommendation* at 26.

<sup>63</sup> *Id.*

<sup>64</sup> See *Recommended Decision* at ¶ 17.

other sources such as insurance, RUS loans, and federal or state emergency management relief.”<sup>65</sup> Accordingly, the *FNPRM* seeks comment on “whether the proposed ability of incumbent LECs to adjust their fixed per-line support levels to recover costs associated with catastrophic events should be limited by the availability of support” from the sources identified by the Joint Board.<sup>66</sup>

As an initial matter, Innovative Telephone supports the catastrophic event recommendation of the RTF as a reasonable compromise that will enable rural and insular carriers to obtain sufficient universal service support, even when they are burdened by the substantial additional costs associated with extraordinary catastrophic events. Innovative Telephone accepts the RTF’s proposal to freeze per-loop costs in a study area once a CETC commences operations in that area. A necessary proviso, however, is the adoption of the narrow catastrophic event exception. Without this exception, rural and insular carriers will not receive sufficient support to preserve, let alone advance, universal service, as mandated by Section 254.

The RTF included the catastrophic event exception in its *Recommendation* to preserve the existing *status quo*. As it has recently noted, under the existing system, carriers may recover costs resulting from natural disasters from universal service funding.<sup>67</sup> The RTF’s proposed catastrophic event adjustment merely provides for *continued* recovery of such costs after the Commission adopts the *RTF Recommendation*, which includes a “freeze” on per-loop support in

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<sup>65</sup> *Id.* at ¶ 18.

<sup>66</sup> *FNPRM* at ¶ 6.

<sup>67</sup> *See* RTF Comments, CC Docket No. 96-45, Feb. 20, 2001 (“RTF Comments”) at 9.

a study area once an approved CETC commences providing service.<sup>68</sup> The provision thus does nothing more than *maintain* the existing level of support.

Indeed, without this adjustment, insular and rural carriers would not be able to obtain increased universal service support to meet dramatically increased costs that may result from destruction caused by natural disasters. Recent comments filed by the RTF in this proceeding address this precise issue:

It is axiomatic that the ability of an insular or rural company to rebuild its network after a disaster is critical to providing universal service to all Americans, the policy at the heart of Section 254 of the 1996 Act. The catastrophic events relief provision in the RTF Recommendation is crucial to the new rural and insular universal service mechanism. The new frozen per-line support provision could limit the ability of rural and insular carriers to recover from disasters and preserve universal service because the per-line support would not include the extraordinary cost of recovering from a disaster that occurred after the support was frozen. Therefore, a limited exception to the per-line freeze in competitive study areas was necessary to fulfill Section 254's universal service mandate for insular and rural areas.<sup>69</sup>

Accordingly, the narrow exception recommended by the RTF is essential to ensure that insular and rural carriers receive "sufficient" support in times of greatest need.

The *FNPRM* notes that one party has previously submitted comments asserting that universal service "fund[s] should not become [a] substitute for carriers' insurance policies."<sup>70</sup>

This is, of course, true. Critically, the catastrophic event provision will not change the fact that

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<sup>68</sup> *See id.*

<sup>69</sup> *Id.*

<sup>70</sup> *FNPRM* at ¶ 18, n.51 (quoting Sprint Corporation Comments, CC Docket No. 96-45, Nov. 3, 2000, at 3).

universal service support cannot replace the need for carriers to obtain private insurance coverage. As noted above, under the existing universal service mechanism, carriers already may recover costs incurred in the aftermath of natural disasters. Yet, this ability has not led rural and insular carriers to eschew insurance coverage. This is for good reason. Carriers currently obtain insurance, and will continue to obtain insurance where available at reasonable rates, because they always face a risk that a regulator will not adequately compensate it for investments made following a catastrophic event.<sup>71</sup> The existence of this regulatory risk ensures that carriers will obtain private insurance coverage whenever possible and prudent in order to protect the value of their shareholders' investments.

It is important to note, however, that the motivation to obtain insurance coverage does *not* negate the need for the catastrophic event provision. As the RTF observes, “at times, carriers have not been able to obtain reasonably priced insurance, such as during the early 1990s when Caribbean and Atlantic hurricanes caused such extensive damage to telephone outside plant that insurance coverage was not available for many years.”<sup>72</sup> Innovative Telephone itself has experienced such difficulty following several hurricanes. The catastrophic event provision is thus critical to enable rural and insular carriers to maintain rates that are reasonably comparable to rates charged in non-rural areas. This is especially so, because another consequence of devastating natural disasters is the reduction in the customer base served by the rural or insular carrier resulting from the destruction of homes and businesses, with the concomitant increase in per-line costs.<sup>73</sup> Moreover, the provision would allow carriers to recover only costs *not*

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<sup>71</sup> See *id.* at 10, n.4.

<sup>72</sup> *Id.*

<sup>73</sup> See *id.* at 10.

reimbursed by a carrier's insurance carrier.<sup>74</sup> Thus, as today, there would be no possibility of "double recovery."

Nor do other potential sources mentioned in the *FNPRM* reduce the necessity for the catastrophic event provision. The availability of RUS loans after a disaster to finance reconstruction only delays the inevitable: the loans must be paid back from carrier funds.<sup>75</sup> Thus, the availability of RUS or other loans does not replace the need for carriers to obtain universal service support to recover increased costs resulting from natural disasters. The existence of federal or state emergency relief provides even less reason for the Commission to pause. As the RTF explains, "federal and state emergency grants are usually not available to private companies."<sup>76</sup> In any event, even if some form of emergency relief were available to a carrier, the catastrophic event provision would only permit recovery of costs *not* recovered from these (or any other) sources.<sup>77</sup>

In sum, the RTF recommendation for a catastrophic event adjustment is a reasonable means of providing carriers with sufficient support to deal with unpredictable cost "spikes" without jeopardizing the availability of reasonably comparable rates to consumers in "rural, insular, and high cost areas."<sup>78</sup>

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<sup>74</sup> *See id.*

<sup>75</sup> *See id.*

<sup>76</sup> *Id.*; *see also id.* at n.6 (observing that federal disaster assistance is not available to for-profit business entities).

<sup>77</sup> *See id.* at 10.

<sup>78</sup> 47 U.S.C. § 254(b)(3).

**B. The Proposed “Safety Valve” Mechanism Represents a Reasonable, Lawful, Compromise Position.**

The *RTF Recommendation* recommends that the Commission establish an appropriate “safety valve” mechanism for insular and rural carriers that acquire access lines due to a sale or merger to reduce the burden imposed by the Commission’s “merger and acquisition cap” on universal service support.<sup>79</sup> This mechanism would allow rural carriers, in limited circumstances, to receive an adjustment in support in areas where they have acquired access lines, so that they may recover *a portion* of their additional investments in infrastructure.<sup>80</sup> Although Innovative Telephone supports elimination of the merger and acquisition cap, the proposed “safety valve” mechanism represents a reasonable and acceptable compromise between the diverse interests represented on the RTF, and between the interests of both net contributors and net recipients of universal service support. For this reason, the Joint Board supports the adoption of this “safety valve” mechanism.<sup>81</sup> Innovative Telephone urges the Commission to follow the Joint Board’s recommendation and adopt this provision.

As noted in the *FNPRM*, several aspects of the “safety valve” mechanism need to be clarified prior to implementation. First, Innovative Telephone’s supports the RTF’s position that if the aggregate cap on “safety valve” adjustments proposed in the *RTF Recommendation* is

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<sup>79</sup> See *RTF Recommendation* at 29-30; see also 47 C.F.R. § 54.305 (2000).

<sup>80</sup> As an illustrative “example,” the *RTF Recommendation* suggests that an insular or rural carrier would recover only 50% of any year-on-year increase in infrastructure investments following an acquisition of lines, subject to an aggregate “safety valve” ceiling of 5% of the indexed high cost loop fund cap. See *RTF Recommendation*, App. D, ¶¶ 7, 8, at 44.

<sup>81</sup> See *Recommended Decision* at ¶ 16.

exceeded, then carriers should receive support under this mechanism on a *pro rata* basis.<sup>82</sup> It is important to note that the RTF has recently clarified that the *RTF Recommendation* does not include a “proposed cap of five percent of the high-cost loop support fund,” as stated in the *FNPRM*.<sup>83</sup> Instead, the 5% figure “was used illustratively” and the RTF “took no position on what that cap should be.”<sup>84</sup> Innovative Telephone believes that the Section 254 mandate to provide carriers with “sufficient” universal service support justifies the use of a “safety valve” mechanism. Any aggregate cap should be sufficiently high so as not to undermine universal service for customers in “safety valve” areas.

With regard to the definition of “meaningful investment,” Innovative Telephone supports the use of the definition provided in the *RTF Recommendation*. Under this definition, a carrier’s expense adjustment would be calculated based upon an “index year expense adjustment” established at the end of the first year of operations of the acquiring carrier.<sup>85</sup> In other words, the “safety valve” adjustment is based solely on “*post-acquisition* net annual increases in interstate telecommunications plant assets.”<sup>86</sup>

In the *FNPRM*, the Commission suggested the possible use of an alternative definition, which would define “index year expense adjustment” based upon the last year immediately *prior* to the merger or acquisition.<sup>87</sup> This definition, however, does not provide an appropriate basis

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<sup>82</sup> See RTF Comments at 6 (recommending proportional distribution of funds if the cap is exceeded).

<sup>83</sup> *FNPRM* at ¶ 5.

<sup>84</sup> RTF Comments at 6.

<sup>85</sup> See *RTF Recommendation*, App. D, ¶ 7(a), at 44.

<sup>86</sup> RTF Comments at 6-7 (emphasis added).

<sup>87</sup> See *FNPRM* at ¶ 5, n.15.

for calculation of subsequent “safety valve” adjustments. Different carriers utilize different methods of accounting, including different general and administrative and overhead rates. The approach in the *FNPRM* would use the *selling* carrier’s recorded expenses to establish the “index year expense adjustment” and compare this to the *acquiring* carrier’s “expense adjustments” in future years. This methodology creates an “apples to oranges” comparison that would result in an inappropriate compensation mechanism. Accordingly, the RTF’s proposed methodology provides a more appropriate means of relieving insular and rural carriers from the strictures of the existing merger and acquisition cap.

Finally, Innovative Telephone urges the Commission *not* to adopt a new provision that would fix the level of “safety valve” support in competitive study areas in the same manner that the RTF has proposed “freezing” per-loop support.<sup>88</sup> The rationale that supports the adoption of the “safety valve” mechanism – namely, encouragement of new infrastructure investment in insular and rural areas by an acquiring carrier – applies equally *after* an approved CETC has commenced operations in a study area. For this reason, the RTF did not recommend applying the “freeze” on per-loop support to this mechanism. Indeed, the illustrative example provided in the *RTF Recommendation* notes that per-loop “safety valve” support “would be portable to a CETC operating within the study area.”<sup>89</sup> Subsequently, the RTF has confirmed that “a carrier’s safety valve support should be fully portable and transferred to the acquiring carrier,” which would include a CETC.<sup>90</sup> These provisions demonstrate that the RTF’s recommendation does not contemplate expansion of the “freeze” on per-line support, which was proposed in an entirely

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<sup>88</sup> See *FNPRM* at ¶ 5.

<sup>89</sup> *RTF Recommendation*, App. D, ¶ 9, at 44.

<sup>90</sup> RTF Comments at 7.

different section of the *Recommendation*,<sup>91</sup> to apply to the “safety valve” mechanism. Innovative Telephone opposes any disruption of the carefully crafted compromise encapsulated in the *RTF Recommendation*.

Accordingly, the Commission should adopt the RTF’s modest recommendation to adjust the merger and acquisition cap to encourage infrastructure investment in rural and insular areas. The recommendation deservedly has garnered the support of the Joint Board, and should be adopted by the Commission.

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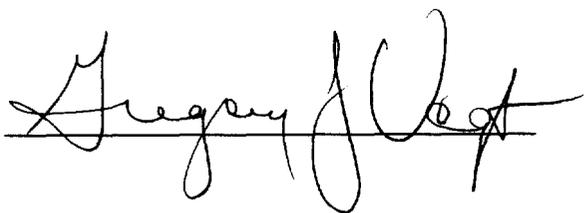
<sup>91</sup> *See RTF Recommendation* at 26.

**IV. CONCLUSION**

Innovative Telephone is heartened by the work of the RTF and the Joint Board. The *RTF Recommendation* represents the consensus of a diverse group that attempted to accommodate widely divergent interests. While the package is not perfect, Innovative Telephone is not willing to let “perfection be the enemy of the good.” It represents a substantial improvement over the existing system, and provides, as the Joint Board observes, “a stable environment for rural [and insular] carriers to invest in rural America.”<sup>92</sup> Thus, for the above reasons, Innovative Telephone urges the Commission to follow the recommendations of the RTF and the Joint Board and act quickly to adopt the package of proposals set forth in the *RTF Recommendation*.

Respectfully submitted,

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February 26, 2001

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<sup>92</sup> *Recommended Decision* at ¶ 1.

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