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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	
Petition for Forbearance of Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom Pursuant to 47 U.S.C. § 160(c)	CC Docket No. 01-331

EMERGENCY PETITION FOR FORBEARANCE

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TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

SUMMARY

Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom ("Iowa Telecom") petitions the Federal Communications Commission ("Commission") for forbearance pursuant to Section 10(c) of the Communications Act. Iowa Telecom requests that the Commission forbear from applying the rule that required price cap carriers to make an election within 60 days after the release of the *CALLS Order* to choose the CALLS plan or to set interstate access rates at forward-looking cost levels (the "60-day rule"). Iowa Telecom did not have a meaningful opportunity to make an informed choice at the only time this election was permitted because it began operations only 30 days prior to the election date, and it did not have a reasonable opportunity to acquire the information to make an informed decision within the timeframe allowed. Alternatively, Iowa Telecom requests that the Commission forbear from enforcing the target rate set for the Average Traffic Sensitive ("ATS") charge prescribed in Section 61.3(qq) of the Commission's rules, and allow Iowa Telecom to reset its ATS at cost-based levels.

Iowa Telecom faces unique circumstances that justify forbearance in this instance. First and foremost, Iowa Telecom did not commence operations until July 2000, the same month in which price cap carriers were required to elect between the two options in the *CALLS Order*. The lack of time, together with Iowa Telecom's then lack of experience and expertise, precluded Iowa Telecom from making a meaningful election decision. Second, Iowa Telecom service territory is entirely rural. Third, the network acquired from GTE requires extensive further investment to complete modernization that would improve the quality of interstate (as well as intrastate) access services and provide its rural customers with access to the Internet, including broadband capability. Fourth, Iowa Telecom faces high per-line costs to upgrade its

infrastructure due to the highly dispersed configuration of its network. Fifth, Iowa Telecom is facing significant competition from numerous facilities-based competitors, most of which are overbuilding Iowa Telecom's network. These competitors are rapidly capturing a large share of Iowa Telecom's customers in competitive exchanges, particularly the high volume, high revenue customers in these towns.

Moreover, Iowa Telecom must fund the significant cost of modernizing its infrastructure from internal operations. The company qualifies for only limited federal universal service support due to regulatory constraints and the cumulative effects of years of underinvestment in its acquired infrastructure. No state universal service fund exists. Furthermore, Iowa Telecom is unable to obtain adequate funding from capital markets because of its existing substantial debt (from the recent acquisition from GTE) and the present market climate, which is not receptive to security issuances by telecommunications companies. The current economic slowdown and the uncertainty arising from the events of September 11, 2001, have made the problem even worse.

Given these circumstances, Iowa Telecom must generate funds from internal operations. The current ATS target rate is too low, however, to fund the infrastructure investments that Iowa Telecom needs to make. Iowa Telecom is therefore seeking forbearance from the 60-day rule so that it may reset interstate access rates based on the FCC standard forward-looking economic costs. Iowa Telecom notes that it does not endorse the use of Total Element Long Run Incremental Cost ("TELRIC") generally, or the Synthesis Model in particular, to establish interstate access rates. Nevertheless, because the Commission has endorsed TELRIC and the Synthesis Model, Iowa Telecom proposes to follow this same cost-based methodology.

The statutory forbearance criteria in Section 10 of the Communications Act each weigh in favor of granting this Petition. Enforcement of the 60-day rule is not necessary to ensure that

Iowa Telecom's access rates remain just and reasonable where, as here, the company would set its rates based on forward-looking economic cost, which the Commission has recognized in the past as both reasonable and desirable. Nor is enforcement of the 60-day rule necessary to protect consumers, because it would allow Iowa Telecom to adopt cost-based access rates, which the Commission has stated reflect rates that would be achieved in a fully competitive market. Finally, granting forbearance would be in the public interest because: (1) it would allow Iowa Telecom to upgrade its network to provide its rural customers with improved quality access services and to bring broadband capability to rural communities; (2) it would foster deployment of advanced services and thus further the objectives of Section 706 of the Communications Act; and (3) it would allow Iowa Telecom to compete with its many facilities-based competitors on a more even footing, thus creating the possibility of sustained competition in rural Iowa.

Accordingly, Iowa Telecom requests the Commission to grant this Emergency Petition for Forbearance. Iowa Telecom requests that the Commission grant the requested relief promptly so that it can implement the rule changes in time for its July 1, 2002 annual access filing.

In the alternative, Iowa Telecom requests that the Commission forbear from enforcing the target rate set for the Average Traffic Sensitive ("ATS") charge prescribed in Section 61.3(qq) of the Commission's rules, and allow Iowa Telecom to reset its ATS at cost-based levels.[4] As discussed in detail below, Iowa Telecom faces unique circumstances that justify forbearance under the three-prong test established by Section 10(c) of the Act, under either of these alternate approaches.

The current ATS target rate is unreasonably low. The relief requested should be granted in light of: (1) Iowa Telecom's need to modernize its infrastructure and increase the availability of advanced services, which would close the gap between the company's rural customers and consumers in urban areas; (2) the inability of Iowa Telecom to raise sufficient capital except through ongoing operations; and (3) the inflexibility of the Commission's regulatory rules in circumstances, such as here, where substantial infrastructure investment is required and substantial facilities-based competition is present. Iowa Telecom requests that the Commission promptly grant the requested emergency relief so that Iowa Telecom can implement the rule changes in time for its July 1, 2002 annual access filing.

I. BACKGROUND

Iowa Telecom was formed in 1999, but did not commence operations until July 1, 2000 following the purchase of the 296 local exchanges formerly operated by GTE Midwest, Inc. ("GTE"). These exchanges are scattered throughout various parts of rural Iowa and are divided

[4] 47 C.F.R. § 61.3(qq).

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EMERGENCY PETITION FOR FORBEARANCE

Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom ("Iowa Telecom") petitions the Federal Communications Commission ("Commission") for forbearance pursuant to Section 10(c) of the Communications Act.[1] Iowa Telecom requests that the Commission forbear from applying the rule that required price cap carriers to make an election within 60 days after the release of the *CALLS Order*[2] to choose the CALLS plan or to set interstate access rates at forward-looking cost levels (the "60-day rule").[3] Iowa Telecom did not have a meaningful opportunity to make an informed choice at the only time this election was permitted because it began operations only 30 days prior to the election date, and it did not have a reasonable opportunity to acquire the information to make an informed decision within the timeframe allowed.

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1 47 U.S.C. § 160(c).

2 Access Charge Reform, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (2000) ("*CALLS Order*"), *aff'd in part, rev'd in part, Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

3 *Id.* ¶ 61.

into two tariff entities for interstate access services.[5] *See* Exhibit 1 (map showing Iowa Telecom's exchanges). The largest town served by Iowa Telecom is Newton, which has a population of only 15,579 according to 2000 census data published by the U.S. Bureau of the Census. None of the other small towns served by Iowa Telecom has a population over 10,000. Yet, Iowa Telecom's service territory is dispersed over an area of approximately 20,000 square miles – more than one-third of the State of Iowa. As a result, Iowa Telecom's service territory has only fourteen access lines per square mile, far below the teledensity of nineteen lines per square mile that the Commission adopted as the criterion for "very low-density price cap LECs" in the *CALLS Order*.[6] In short, Iowa Telecom provides local exchange service exclusively to customers that live in rural communities.[7]

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[5] For purposes of tariff filings with the Commission, Iowa Telecom's exchanges are separated into two "service groups": the Iowa Telecom Service Group and the Iowa Telecom Systems Service Group. *See* Iowa Telecom Tariff FCC No. 1, §§ 1.1.1, 1.1.2. For purposes of federal universal service support, however, Iowa Telecom's territory is divided into three study areas: Iowa Telecom North (Study Area Code ("SAC") 3351167), Iowa Telecom Systems (SAC 3351170), and Iowa Telecom (SAC 3351178). The Iowa Telecom Service Group tariff entity coincides with the Iowa Telecom North study area. The Iowa Telecom Systems Service Group tariff entity combines the Iowa Telecom Systems and Iowa Telecom study areas for tariff purposes.

[6] *CALLS Order*, 15 FCC Rcd 12962, ¶ 162; *see also* 47 C.F.R. § 61.3(qq).

[7] Because Iowa Telecom serves such a rural population, it qualifies as a rural telephone company as defined by Section 3(37) of the Communications Act, as amended. 47 U.S.C. § 153(37). Indeed, Iowa Telecom qualifies under three of the four tests available in that section:

- None of Iowa Telecom's three study areas includes any territory within an urbanized area as defined by the U.S. Bureau of the Census as of August 10, 1993;
- Iowa Telecom provides local exchange service to two study areas with fewer than 100,000 access lines; and
- Iowa Telecom has no access lines (*i.e.*, far fewer than 15%) in communities of more than 50,000 as of February 8, 1996, the date of enactment of the Telecommunications Act of 1996.

See 47 U.S.C. § 153(37)(A), (C), and (D).

Despite the rural nature of its service area, Iowa Telecom is a price cap carrier and subject to the full panoply of the Commission's price cap regulations. In the Spring of 2000, prior to commencing operations, and prior to the adoption of CALLS, Iowa Telecom elected to be regulated as a price cap carrier like its predecessor, GTE, rather than as a rate-of-return carrier. Iowa Telecom thus became (and remains) the nation's smallest price cap carrier. This decision was the least disruptive to Iowa ratepayers since GTE had been operating pursuant to price caps for almost ten years, and rate changes associated with rate-of-return regulation could have been considerable. In addition, maintaining price cap regulation was in the public interest because it allowed Iowa Telecom to retain some measure of pricing flexibility and provided the company with an incentive to operate efficiently.

During the Spring of 2000, Iowa Telecom was aware of the CALLS plan, which had been presented by a coalition of four of the five largest incumbent local exchange carriers ("ILECs") and two of the three largest interexchange carriers ("IXCs"), but it did not know the details of the CALLS plan development, and was not involved in the day-to-day developments and changes to the plan. At that time, CALLS was proposed as a purely voluntary, opt-in plan.[8] Under the proposed plan, price cap carriers that elected not to opt-in would remain under the Commission's existing price cap regulations. Accordingly, Iowa Telecom structured the financing for the acquisition of GTE's Iowa property "based on the FCC's [then] current price cap rules."[9] Moreover, after studying the proposed CALLS plan, Iowa Telecom determined that CALLS "would likely have a severely negative financial impact on Iowa Telecom, which, in turn would surely jeopardize its ability to serve much of rural Iowa with high-quality basic and advanced

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8 *See CALLS Order*, 15 FCC Rcd 12962, ¶ 50.

9 Ex Parte Submission of Iowa Telecom, CC Docket No. 96-262, Apr. 14, 2000, at 2.

telecommunications services."[10] In a May 26, 2000 ex parte filing, Iowa Telecom noted that, given the size and rural nature of the exchanges it would acquire and the financial demands on the company, it would not opt into the CALLS plan, but would instead choose to "remain regulated pursuant to the existing price cap rules consistent with the voluntary nature of the CALLS plan."[11] Iowa Telecom urged the Commission not to make CALLS mandatory for all price cap carriers.[12]

On May 31, 2000, the Commission adopted and released the *CALLS Order*, which made many aspects of the CALLS proposal mandatory on all price cap carriers.[13] Other aspects of the CALLS plan – namely the rate-level components of the proposal – were not mandatory. However, the Commission did not give price cap carriers the option of remaining under existing price cap regulation as the CALLS plan originally proposed. Instead, the Commission offered price cap carriers only two choices: subscribe to the entire CALLS proposal for its five-year term, or commit to rates based on forward-looking costs.[14] Under this second alternative, carriers were required "to submit a cost study based on forward-looking economic costs."[15] Moreover, the Commission required price cap carriers irrevocably to elect which of these

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[10] Letter from James U. Troup to Magalie Roman Salas, Secretary, FCC, CC Docket No. 96-262, May 26, 2000, at 2.

[11] *Id.* at 1.

[12] *See id.* at 2.

[13] These include the new SLC caps, elimination of the residential PICC, multi-line business PICC caps, and recovery of universal service contributions directly from end users. *See CALLS Order*, 15 FCC Rcd 12962, ¶ 58.

[14] *See id.* ¶ 59.

[15] *Id.*

regulatory paths to take within 60 days from the release of the *CALLS Order*, *i.e.*, by July 31, 2000, and made this election binding for the duration of CALLS.[16]

Submission of a cost study based on forward-looking economic costs was not a feasible option for Iowa Telecom at that time. On May 31, 2000, when the *CALLS Order* was released, Iowa Telecom had not even commenced operations. Even after it commenced operations on July 1, 2000, Iowa Telecom did not have an adequate opportunity to assess the cost study option. During its first month of operation, the company had to focus on accomplishing a smooth transition from GTE, learning the operations, and serving its newly-acquired customer base. As a new company, it also lacked the knowledge and experience necessary to prepare a forward-looking cost study, or to assess the financial viability of the cost study option. Indeed, because of the company's lack of experience with federal regulations, GTE prepared Iowa Telecom's July 1, 2000 annual access tariff filing. Quite simply, Iowa Telecom lacked the capability to make a meaningful election within its first 30 days of operation. Furthermore, the understanding at that time in the industry was that interstate access rates based on forward-looking costs would be significantly lower than under existing price cap regulation.

Given all these circumstances, and the requirement to make an election by July 31, 2000, before the end of its first month of operations, Iowa Telecom elected the "devil it knew (a little)" (CALLS), rather than the "devil it didn't know" (a forward-looking cost study). Under CALLS, Iowa Telecom became subject to an ATS target rate of 0.95 cents per minute because it has a teledensity of less than nineteen access lines per square mile.[17]

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16 *See id.* ¶ 61.

17 *See* 47 C.F.R. § 61.3(qq)(2).

Today, Iowa Telecom has achieved this target rate in each of its study areas, and is in the process of phasing out the carrier common line ("CCL") charge throughout its service territory as SLC rates increase. Compliance with the ATS target rate, however, has severely restricted Iowa Telecom's ability to fund the significant infrastructure investments that are necessary to upgrade the plant acquired from GTE.

II. IOWA TELECOM FACES A COMBINATION OF CIRCUMSTANCES THAT ARE NOT FACED BY OTHER PRICE CAP ILECS

The financial constraints faced by Iowa Telecom result from a combination of circumstances that are perhaps not faced by any other price cap carrier. As one would expect, considering its status as the nation's smallest price cap carrier, and as a rural telephone company, Iowa Telecom does not fit the profile typical of other price cap carriers. Iowa Telecom's present situation is the result of a number of particular circumstances that, in combination, make Iowa Telecom unique.

First, as noted above, given the fact that Iowa Telecom did not commence operations until July 2000, it simply did not have a meaningful opportunity to evaluate the two options under CALLS and to make a decision that would bind the company for a period of five years. Under CALLS, Iowa Telecom was required to make this election in the same month that it initiated operations. This abrupt timetable precluded a meaningful election decision.

Second, Iowa Telecom's service territory is entirely rural. Iowa Telecom does not serve any metropolitan or urban areas. Iowa Telecom does not serve any cities or large towns – Newton, the largest town it serves, has a population of less than 16,000. Remarkably, only eight of Iowa Telecom's 296 exchanges serve more than 5,000 access lines. More than half of Iowa

Telecom's exchanges have fewer than 500 access lines; more than 75% of its exchanges have fewer than 1,000 lines.

Third, despite Iowa Telecom's considerable efforts to invest in infrastructure since it commenced operations on July 1, 2000,[18] the network remains relatively outdated and requires extensive further investment to complete modernization. For example, the quality of access services, both intrastate and interstate, needs to be improved through investments in loop, switching and transport infrastructure. Furthermore, much needs to be done to improve the infrastructure that can enable Iowa Telecom's customers to access the Internet, both via broadband services and otherwise. Although Iowa Telecom has now brought dial-up Internet access to all of its 296 exchanges, many of its most remote customers still do not have access to this increasingly essential service. Broadband capability at present is limited to only a handful of Iowa Telecom's exchanges. Even in those exchanges, the company's infrastructure and/or long loop lengths sometimes limit download speeds. Many custom local area signaling service ("CLASS") features, such as caller ID, call trace, and automatic busy redial, presently are available in fewer than two-thirds of its exchanges. Further, voice-mail service is available only in forty-two of Iowa Telecom's exchanges.

Fourth, the rural nature of Iowa Telecom's service territory dictates that the per-line cost of upgrading the network will be higher than for most other price cap carriers. Iowa Telecom's service area has a very low teledensity of fourteen lines per square mile and a high average loop length. On average, there are fewer than 1,000 lines in each of Iowa Telecom's exchanges. As a

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[18] Iowa Telecom has established an annual capital budget plan that includes investment levels (measured as a percentage of revenues) that are at least equal to the average capital investment levels for other mid-sized ILECs.

result, the cost of replacing and upgrading switches cannot be spread over a large number of lines.

Fifth, Iowa Telecom is facing significant competition from more than a dozen facilities-based competitors that have overbuilt Iowa Telecom's network in more than thirty of its exchanges. Most of these competitors are affiliated with neighboring ILECs; the remainder are municipal competitive local exchange carriers ("CLECs"). All of these competitors enjoy greater access charge pricing flexibility than Iowa Telecom at both the state and federal level. As a result, these competitors are rapidly eroding Iowa Telecom's customer base in each exchange that they enter. Further, all signs indicate that competition will continue to grow at a rapid pace. The loss of lines in competitive exchanges exacerbates the other previously mentioned circumstances because it increases Iowa Telecom's per-line costs for infrastructure improvements, and further hampers its ability to improve the quality of access services.

Combined, these circumstances severely restrict Iowa Telecom's ability to provide its rural customers with an upgraded network and improved access services under the constraints of the ATS target rate. The relief requested in this Petition is thus essential for Iowa Telecom to obtain the regulatory relief necessary to make the investments its customers deserve.

III. SIGNIFICANT INVESTMENT IS NECESSARY TO UPGRADE IOWA TELECOM'S NETWORK

A. Iowa Telecom's Customers Need an Upgraded Network and Access to Advanced Services

Iowa Telecom acquired a network from GTE that requires substantial modernization to improve the quality of voice service, including interstate access, and to make the network fully capable of providing access to data services, both narrowband and broadband. Since

commencing operations in July 2000, the company has already made significant improvements. It has installed the routers and additional equipment necessary to roll-out local dial-up Internet service to all 296 exchanges. Prior to July 2000, GTE did not offer dial-up Internet access to customers in any of its exchanges. Through a program of capital investments, Iowa Telecom has rectified that deficiency. Yet, much more needs to be done, and the necessary improvements will require considerable additional investment.

1. Iowa Telecom Needs to Replace Outdated Plant to Improve the Quality of Intrastate and Interstate Voice Service for Its Customers

The infrastructure acquired from GTE requires substantial investment to improve the quality of voice service, including intrastate and interstate access services. The plant is old and highly depreciated. GTE, like other large non-rural ILECs, had focused investment in non-rural areas and not the plant in rural areas, including its Iowa properties. As a result, significant investment is needed to transition the network – including local loops, switching equipment, and transport facilities – to a more modern voice and data network. These network upgrades will improve the quality of voice service for all of Iowa Telecom's customers and provide a network platform that will enable advanced data products to be made available in rural areas.

On the loop side, two areas of immediate concern are the replacement of lead-sheathed cable and the replacement of analog carrier with digital carrier. These two plant upgrades will improve the signal to noise ratio experienced by Iowa Telecom's customers, improving the quality of intrastate and interstate voice service. The full deployment of digital carrier is a necessary component to allow the company to offer the full range of CLASS services in all of its exchanges.

Several upgrades to Iowa Telecom's switching facilities are necessary. First, the company purchased a number of Vidar and Siemens Stromberg Carlson DCO switches, which are now obsolete and must be replaced. Second, numerous other switches are quite old and must be replaced to enable the roll-out of CLASS services and to provide modern switching capabilities, including compliance with Communications Assistance for Law Enforcement Act ("CALEA") requirements.[19] Even in those exchanges where switch replacement is not necessary at present, software upgrades are necessary to improve the functionality of the switches. For example, Iowa Telecom must deploy SS7 software and make DS-1 line module updates and generic switch upgrades. All of these upgrades – of plant and software – would improve the functionality of Iowa Telecom's network, and thus the quality of interstate access service.

Improvements are also needed to interoffice transport facilities. The interoffice facilities acquired from GTE included only a very limited amount of fiber. To reduce signal losses, improve service quality, and expand capacity, newer transport facilities must be deployed, including extensive fiber optic cable placement. These upgrades will improve the quality of interexchange service, including interstate access.

2. CLASS Features and Voice-Mail Service Are Not Yet Available to Many of Iowa Telecom's Customers

Since July 2000, Iowa Telecom has taken significant strides toward expanding the availability of CLASS features and voice-mail service to its customers. The company has expanded the availability of CLASS features, such as caller ID, call trace, and automatic busy redial, to a larger proportion of its customers. Iowa Telecom has also expanded the availability of voice-mail service, from just three exchanges in July 2000 to forty-two exchanges today.

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[19] *See* 47 U.S.C. § 1001-1010; 47 C.F.R. Part 64, Subparts V and W.

Despite these efforts, the deployment of these services remains below desirable levels. For example, eight CLASS features are available in fewer than two-thirds of Iowa Telecom's exchanges.[20] No CLASS features are yet deployed in all of Iowa Telecom's exchanges. Voice-mail deployment is also only partially completed. At present, the service is available in only fourteen percent of Iowa Telecom's exchanges and offered to only nineteen percent of its customers.

3. Greatly Expanded Deployment of Broadband Capability Is Needed in Iowa Telecom's Service Area and Is in the Public Interest

Today, Iowa Telecom's network is capable of providing low-speed analog voice and data services (e.g., dial-up Internet access) to all of its exchanges and to most of the customers within each exchange. However, digital capability and high-speed data services, such as asynchronous digital subscriber line ("ADSL") and high-speed Ethernet connections, are available to less than thirty percent of Iowa Telecom's customers, even after the company's infrastructure investments since July 1, 2000. These investments have permitted the company to deploy high-speed Internet service in twenty-four exchanges since taking over from GTE. Iowa Telecom has rolled out ADSL service in six exchanges and a high-speed Ethernet service in a further eighteen exchanges. However, absent forbearance from either the 60-day rule or the ATS target rate, it will take considerably longer than five years to complete the roll-out of high-speed Internet service to all of its exchanges. Moreover, even in those exchanges where Iowa Telecom has deployed high-speed Internet service, only approximately 75% of customers have access to broadband service. High-speed service is not available to the remaining customers due to the

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[20] These eight CLASS features are automatic busy redial, automatic call return, caller ID name and number, call trace, special call acceptance, special call forward, special call waiting, and VIP alert.

nature of the network purchased from GTE and/or the long loop lengths to remotely located customers.[21] Furthermore, even the minority of Iowa Telecom's customers that today have access to broadband services are restricted in the quality of services they receive. Iowa Telecom's network currently limits broadband service to speeds of 1 Mbps. In contrast, consumers in other parts of Iowa served by more modern networks have access to considerably higher broadband speeds. For example, in Muscatine, Iowa, a town with a population of 22,697, Qwest has upgraded its network to provide access speeds up to 7 Mbps.[22]

The present unavailability of advanced services in 92% of Iowa Telecom's exchanges (272 out of 296 exchanges) illustrates a significant aspect of the digital divide – the considerable disparity regarding access to high-speed and advanced services between customers in Iowa Telecom's rural areas and non-rural areas in the United States.[23] The National Telecommunications and Information Administration ("NTIA") and the Commission have both found that the geographic digital divide with respect to access to broadband Internet services is

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[21] The Commission has observed that long loop length and network quality are two factors limiting the availability of digital subscriber line ("DSL") service. ADSL customers must reside within approximately 18,000 feet of the carrier's nearest central office and that "this factor remains an impediment to DSL deployment in more sparsely populated and remote locations." Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, CC Docket No. 98-146, Second Report, 15 FCC Rcd 20913, ¶ 38 (2000) ("*Second 706 Report*"). Locating DSL equipment close enough to end user premises is significantly more expensive in rural areas with lower population density and greater distances between customers. Outdated infrastructure also limits the maximum speed of DSL service that can be provided. *See id.* ¶ 39 (recognizing that "older loops or loops in need of maintenance . . . pose additional problems for the deployment of DSL service").

[22] *See Second 706 Report*, 15 FCC Rcd 20913, ¶ 145.

[23] *See* NTIA, U.S. Dept. of Commerce, *Fact Sheet: Rural Areas Magnify "Digital Divide"* (July 1999), *available at* http://www.ntia.doc.gov/ntiahome/digitaldivide/factsheets/rural.htm.

considerable: consumers in sparsely populated rural areas are far less likely to have access to high-speed Internet service than those in densely-populated urban areas.[24]

Congress forcefully expressed its desire to bring advanced services, including broadband Internet service, to all Americans, both rural and non-rural, in Section 706 of the Telecommunications Act:

> The Commission and each State commission with regulatory jurisdiction over telecommunications services shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . . by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.[25]

Congress thus signaled its clear intent that the Commission (and the state commissions) ensure that all Americans have comparable access to broadband services. The existence of a significant disparity in access to broadband services in rural and non-rural areas is inconsistent with Section 706.

The Bush administration has recognized that the digital divide between rural and non-rural areas of the U.S. is an important issue and will receive considerable attention.[26] The

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[24] *See* U.S. Dept. of Commerce, *Falling Through the Net: Toward Digital Inclusion*, at 24 (Oct. 2000), *available at* http://search.ntia.doc.gov/pdf/fttn00.pdf (finding that broadband penetration rate in rural areas is 38% lower than in urban areas (7.3% versus 11.8%)); *Second 706 Report*, 15 FCC Rcd 20913, ¶ 88 (finding that "there is a great disparity between population densities with high-speed services reported more often in high density areas than in less dense areas"). The disparity would be even greater if data for urban areas excluded economically depressed city centers.

[25] 47 U.S.C. § 157 note, § (a).

[26] *See Commerce Secretary Nomination*, 107th Cong. (Jan. 4, 2001) (testimony of Donald L. Evans, Nominee for Secretary of Commerce); *see also Capitol Hill*, Communications Daily, Jan. 5, 2001, at 3.

Secretary of Commerce, Donald Evans, has reiterated the administration's commitment to shrinking the digital divide in recent months.[27]

B. Iowa Telecom Faces Significant Costs to Upgrade Plant in Its 296 Exchanges Scattered Across Rural Iowa

The numerous infrastructure upgrades that are needed throughout Iowa Telecom's service territory will require a significant financial investment. According to Iowa Telecom's current estimates, the necessary loop upgrades will require an investment of at least $25 million. Replacement of switches and software upgrades will cost at least $45 million. Improvements to interoffice transport facilities will require an additional $10 million. In total, plant investments of more than $80 million will be necessary to provide Iowa Telecom's customers with improved voice service quality and access to broadband data service.

C. Iowa Telecom Faces High Costs to Deploy Broadband Capability Throughout Its Service Area

Iowa Telecom generally experiences higher costs to upgrade its network to support broadband capability than other price cap carriers, due to the very low teledensity of its network and the low number of lines served by each of its exchanges. On average, Iowa Telecom has approximately 950 lines per exchange.[28] In addition, the average loop length for these lines is more than one mile.

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[27] *See* Donald L. Evans, Remarks Before the Latin American/Caribbean E-Commerce Summit, Buenos Aires, Argentina (Apr. 4, 2001), *available at* http://www.mac.doc.gov/nafta/sp-apr5%231.htm.

[28] Based on September 30, 2001 company data. If the eight largest exchanges are excluded, the average line count for the remaining exchanges is only 764.

IV. IOWA TELECOM NEEDS TO FUND THE NECESSARY AND SIGNIFICANT INFRASTRUCTURE INVESTMENTS FROM INTERNAL OPERATIONS

Traditionally, ILECs have financed infrastructure improvements incrementally either from internal operations (*i.e.*, ongoing service revenues) or from external sources, such as the capital markets. External funding sources, either separately or combined, are insufficient to provide Iowa Telecom with the funding it needs to make the investments discussed in the previous two sections of this Petition over the next few years. Iowa Telecom must be allowed, therefore, to generate the funds it needs from internal operations.

A. Iowa Telecom Is Unable to Fund These Considerable Infrastructure Investments from External Sources

1. Iowa Telecom Qualifies for Only Limited Federal Universal Service Support, and This Support Is Insufficient to Fund the Necessary Infrastructure Investments

Iowa Telecom does not qualify for any support under the High Cost Support Mechanism and receives only limited support under the Interstate Access Support Mechanism. High cost support is precluded under the "parent trap" rule,[29] because GTE did not qualify for such support. Even if the "parent trap" rule were not in effect, Iowa Telecom would not qualify for high cost support because its average cost per loop does not meet the $276 per-loop threshold set by the Commission.[30] This is due to the highly depreciated nature of the plant acquired from GTE,

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[29] 47 C.F.R. § 54.305(a).

[30] This threshold is set at 115% of the $240 national average cost per loop established in the Rural Task Force ("RTF") proceeding. *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Fourteenth Report and Order, 16 FCC Rcd 11244, ¶ 55 (2001) ("*RTF Order*"); *see also* 47 C.F.R. §§ 36.622(a), 36.631.

which had provided only limited financial investment in its Iowa network over a period of several years.

As noted above,[31] Iowa Telecom has established an annual capital budget plan that calls for limited capital investment to improve the capability of its network. Even with these new investments, however, Iowa Telecom's network remains significantly underinvested, with net plant per line of only $1,189. According to a recent study by Legg Mason Wood Walker, Inc. ("Legg Mason"), this figure is thirty-seven percent lower than the average net plant per line for all rural ILECs.[32] Iowa Telecom's low net plant per line figure represents the historical lack of investment and the highly-depreciated state of the plant. The consequence is that Iowa Telecom presently does not qualify for federal high cost support.[33] Furthermore, for the reasons stated

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31 *See supra* note 18.

32 Legg Mason Wood Walker, Inc., *Reshaping Rural Telephone Markets*, Fall 2001, at 86 ("*Legg Mason Rural Telco Study*").

33 The new universal service provisions for rural carriers recently adopted by the Commission in the *RTF Order* fail to provide sufficient recovery of plant investment for Iowa Telecom. For example, the "safety valve" mechanism, which provides a limited exception to the "parent trap" rule, provides support only for exchanges that would otherwise qualify for high cost loop support, *see* 47 C.F.R. § 54.305(b), which is not presently the case for Iowa Telecom. Even if "safety valve" support were available in the future, it permits a rural carrier to recover only 50% of the difference between the carrier's index year and subsequent year expense adjustments for acquired exchanges. *See id.* § 54.305(d). In addition, "safety valve" support is limited to 5% of the high-cost loop support received by rural carriers. *See id.* § 54.305(e). Further, Iowa Telecom apparently would not be eligible for "safety net" support because that mechanism applies only to existing exchanges, not acquired exchanges. *See RTF Order*, 16 FCC Rcd 11244, ¶ 106; *see also* 47 C.F.R. § 36.605(a). Moreover, the lag time inherent in universal service support precludes this source for purposes of meeting Iowa Telecom's pressing needs. The lag time is especially long with regard to "safety valve" support because a rural carrier cannot qualify for such support until the year following the "index year," which itself is set as a carrier's first full year operating the acquired exchanges. *See* 47 C.F.R. § 54.305(c). Thus, Iowa Telecom would not be eligible to receive "safety valve" support for a considerable time.

below,[34] Iowa Telecom does not have available external sources of funding to make the investment necessary to trigger future high cost loop support.[35]

The only federal universal service support received by Iowa Telecom is under the Interstate Access Support Mechanism. According to the most recent projections by the Universal service Administrative Company ("USAC"), Iowa Telecom will receive $518,894 in monthly support for all three of its study areas combined.[36] This support is for 297,240 loops,[37] resulting in monthly per-loop support of $1.75. Although this support is not insignificant, it serves only to offset a portion of the previously implicit support provided by interstate access service. Even with this Interstate Access Support, Iowa Telecom does not recover its costs of providing interstate access service.[38] Interstate Access Support thus does not provide a "surplus" that can be used to fund the necessary infrastructure upgrades that are needed in each of Iowa Telecom's study areas.

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34 *See infra* section IV.A.3.

35 *See Legg Mason Rural Telco Study* at 88 (observing that "the conundrum is that Iowa Telecom has to make significant investment to qualify as high-cost plant, but cannot currently generate the revenues (rates are too low) to justify such a financial commitment").

36 *See* USAC, Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2002, Appendix HC1, at 6 (Nov. 2, 2001), *available at* http://www.universal service.org/overview/filings.

37 *See id.*

38 *See Legg Mason Rural Telco Study* at 88 (noting Legg Mason's estimate that Iowa Telecom's net revenue loss due to the implementation of CALLS is $3.4 million annually, even with the addition of Interstate Access Support).

2. Iowa Telecom Receives No State Universal Service Support

The State of Iowa does not operate a state universal service fund. Therefore, the federal Universal Service Fund represents the only possible source of universal service support for Iowa Telecom.

3. Iowa Telecom Is Unable to Obtain Adequate Funding from the Capital Markets

The capital markets represent a traditional external source of funding for investments by ILECs and other telecommunications carriers. Carriers typically have two principal options: issuing equity or debt securities. However, two factors presently make it impracticable for Iowa Telecom to raise capital through either the issuance of equity or debt. First, Iowa Telecom assumed a substantial amount of debt to complete the acquisition from GTE. Iowa Telecom incurred this debt less than two years ago to fund the acquisition and insufficient time has elapsed to significantly reduce the level of debt. Given Iowa Telecom's existing debt situation, the capital market demands a higher price for additional capital. At this time, it would be imprudent, if not impossible, for Iowa Telecom to incur significant additional debt or to float significant additional equity.

Second, the current market climate is not conducive for telecommunications companies to raise capital. Since Iowa Telecom began operations in July 2000, the telecommunications sector of the economy has experienced a dramatic slowdown. As a result, investors are far less receptive to new security issuances by telecommunications companies. New issuances of equity have become far more difficult to arrange, and the bond market demands higher coupon rates on debt securities to compensate for the high level of uncertainty regarding the future health of this sector of the economy. The events of September 11, 2001, of course, have only made matters

worse, by causing a broad economic downturn that has led the economy into recession. Recent events have also postponed the prospect of economic recovery and made the capital markets less certain about the predictability of companies' future earnings.

Taken together, the circumstances that now face Iowa Telecom dictate that the only prudent financial course for Iowa Telecom is to limit future capital upgrades of its network to achieve the cash flows and returns demanded by its investors.[39]

B. Iowa Telecom Must Generate Funds from Internal Operations at a Time When It Is Facing Significant Competition from Facilities-Based Competitors

1. Iowa Telecom's Existing Rate Levels Are Not Sufficient to Support an Expanded Investment Program

For the reasons noted in the previous section, Iowa Telecom has only one practicable option – to fund an expanded infrastructure investment program from internal operations. Yet, under existing rate levels, Iowa Telecom does not generate sufficient revenues to expand its existing capital investment program.[40] Iowa Telecom's capital plan reflects a prudent level of investment based on existing rate levels, which include subscriber line charges ("SLCs") at the cap levels set in the *CALLS Order*.[41] It would be imprudent and impracticable for Iowa Telecom to make additional significant investments absent some form of relief from existing rate levels,

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39 *See Legg Mason Rural Telco Study* at 93.

40 *See id.* ("Iowa Telecom does not generate sufficient revenues to justify additional investment in plant, so that the company is likely to engage in a prudent financial course (telecommunications today is a business, not a charity), which means that the company will limit the capital upgrade of the network to achieve cash flows and returns required by its investors.").

41 Iowa Telecom's primary residence and business single-line SLC is $5.00, the non-primary residential SLC is $7.00, and the business multi-line SLC is $9.20. *See* Iowa Telecom Tariff FCC No. 1, § 13.11. These rates are set at the cap levels established by CALLS. *See* 47 C.F.R. § 69.152(d)(1), (e)(1), (k)(1).

such as forbearance from the ATS target rate.[42] To enable the company to fund the needed infrastructure improvements, it is pursuing options for regulatory relief with the Iowa Utilities Board ("IUB") and the Iowa Legislature to enable it to fund the intrastate portion of anticipated upgrade costs.

2. Iowa Telecom Faces Significant Competition from Numerous Facilities-Based Competitors That Are Rapidly Eroding Iowa Telecom's Market Share in Competitive Exchanges

Another factor limiting the ability of Iowa Telecom to invest in its infrastructure is the rising level of competition in each of its study areas. CLECs are now operating in thirty exchanges in Iowa Telecom's service territory and are rapidly eroding Iowa Telecom's customer base in these exchanges because of more favorable rate regulation at both the state and federal levels. In sixteen exchanges, the CLEC has now taken over from Iowa Telecom as the provider of local exchange service to the majority of access lines. Iowa Telecom's declining customer base in each of its competitive exchanges means that the company also has a declining revenue stream in these exchanges, while the per-line cost of upgrading facilities in these exchanges consequently is rising. The impact of this lopsided competition is to further limit Iowa Telecom's ability to fund additional investment in its network. To address this competitive

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[42] *See Legg Mason Rural Telco Study* at 93. Moreover, becoming a rate-of-return carrier would not be in the public interest because Iowa consumers would lose the benefits of the more efficient pricing mechanisms under price caps. The Commission has long encouraged carriers to adopt the price cap mechanism as a better regulatory mechanism than rate-of-return regulation. *See* Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, ¶ 26 (1997) ("*Access Charge Reform Order*") ("Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable levels."), *aff'd sub nom. Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998); *see also CALLS Order*, 15 FCC Rcd 12962, ¶ 14 (noting that the Commission's "price cap plan for LECs was intended to avoid the perverse incentives of rate-of-return regulation").

imbalance, Iowa Telecom is presently seeking relief from state price regulation in eight competitive exchanges where the company has experienced significant loss of market share.[43]

The competitive environment in Iowa is perhaps unique. Facilities-based competition is rampant, especially in the form of overbuilding by adjacent ILEC subsidiaries and municipal CLECs. To date, sixteen CLECs have commenced operations in thirty exchanges in Iowa Telecom's service territory. Of these, fifteen CLECs have constructed their own facilities, overbuilding Iowa Telecom's network in twenty-three exchanges. The majority of overbuilding CLECs are affiliates of ILECs that operate in territories adjacent to that of Iowa Telecom. The remainder are municipal CLECs, which are increasingly entering Iowa Telecom's service territory.[44] To date, four municipal CLECs are competing with Iowa Telecom by means of their own hybrid fiber/coaxial networks. Heightening the competitive pressure on Iowa Telecom, overbuilding CLECs have deployed facilities in the most densely populated areas of towns, leaving Iowa Telecom to serve the most rural, highest cost customers in these communities.

The regulatory advantage held by these competitors has ensured that they are able to rapidly capture customers from Iowa Telecom. CLECs have several regulatory advantages. At

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[43] *See* Petition for Deregulation of Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom, IUB Docket No. INU-01-1, Aug. 9, 2001.

[44] An Iowa statute enacted in April 1997 expanded the definition of "competitive local exchange service provider" (*i.e.*, CLEC) to include municipal utilities and authorized the IUB to issue certificates of public convenience and necessity to such municipal CLECs. *See* Iowa Code §§ 476.1B(3), 476.96(3); *see also Second 706 Report*, 15 FCC Rcd 20913, ¶ 150 & n.198. Since enactment of that statute, more than forty Iowa municipalities have established telecommunications utilities to compete directly with ILECs in the provision of local exchange service.

the state level, they are not subject to price regulation.[45] In contrast, Iowa Telecom's intrastate access services are subject to price cap regulation. As a result, Iowa Telecom's competitors charge far higher intrastate access rates than Iowa Telecom.[46] At the federal level, CLECs are presently permitted to tariff interstate access rates as high as 2.5 cents per minute,[47] which is more than double the rate charged by Iowa Telecom under CALLS.[48] The existing regulatory framework thus allows CLECs to tariff substantially higher interstate access rates than Iowa Telecom, irrespective of the CLECs' actual costs.

This regulatory freedom – at both the state and federal level – provides CLECs with a distinct competitive advantage over Iowa Telecom. Higher intrastate and interstate access rates provide these CLECs with significant sources of revenue that is not available to Iowa Telecom and allow them to undercut Iowa Telecom's local telephone rates.[49] Iowa Telecom's competitors

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[45] They are required to file tariffs for local exchange and intrastate access services, but they are exempt from IUB price regulation. *See* Iowa Code § 476.101(1) (exempting CLECs from all most of Title XI, subtitle 5, chapter 476 of the Iowa Code, including the price regulation provision, § 476.97). The IUB's jurisdiction with regard to CLEC pricing is limited to investigating formal complaints and prescribing just and reasonable rates in the event it determines that a CLEC's tariffed rates are unjust and unreasonable. *See id.* § 476.3(1).

[46] *See Legg Mason Rural Telco Study* at 89.

[47] *See* Access Charge Reform, CC Docket No. 96-262, Seventh Report and Order, 16 FCC Rcd 9923, ¶ 45 (2001) ("*CLEC Access Charge Order*").

[48] This is true even including Iowa Telecom's traffic-sensitive CCL charge. Iowa Telecom is committed to eliminating the CCL charge in all of its study areas by July 1, 2003.

[49] The Commission has recently acknowledged this phenomenon, noting that "greater access revenues likely permit CLECs to offer lower rates to their end users." *CLEC Access Charge Order*, 16 FCC Rcd 9923, ¶ 28.

have also used these higher access revenues to fund their competitive infrastructure investments.[50]

The ability of CLEC competitors to use these regulatory advantages to undercut Iowa Telecom's local telephone rates has been devastating. Iowa Telecom's market share in these competitive exchanges is falling precipitously. In Oxford Junction, Iowa Telecom's access line market share has fallen to just 5%. Many other exchanges have seen steep declines and in sixteen exchanges – more than half of all competitive exchanges – Iowa Telecom has been displaced as the provider of local exchange service for the majority of access lines. In other words, all that is occurring is a wholesale transfer of the majority of access lines from Iowa Telecom to a competitor. Under existing regulation, Iowa Telecom has no means of protecting its customer base. If the present course continues, Iowa Telecom will be relegated to the position of the provider of local telephone service to a small minority of the highest cost residential customers in each "competitive" exchange.[51] This has already occurred in Oxford Junction, and is set to recur in other exchanges. The result will be a smaller revenue base, lower per-line revenues, and higher per-line costs – a recipe for decreased, not increased, future investment.

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[50] For example, this pricing flexibility enabled Lost Nation-Elwood Telephone Company, which serves fewer than 500 lines through its CLEC operation in Oxford Junction, to deploy more than 22 miles of fiber optic cable. *See* History of the Lost Nation-Elwood Telephone Company, *at* http://showcase.netins.net/web/lostnation/history.htm. As another example, in Guthrie Center, Guthrie Telecommunications Network, Inc., a newly-formed CLEC subsidiary of Panora Cooperative Telephone Association, has begun deploying a fiber-to-the-home network. *See* Press Release, Optical Solutions, Inc., *Optical Solutions, Inc. Drives Fiber-to-the-Home Boom in Iowa with Newest Customer, Guthrie Telecommunications Network Inc.: Residents to Receive State-of-the-Art Voice, Video and Data Services* (Mar. 30, 2001), *available at* http://www.opticalsolutions.com/press/033001.shtml.

[51] The financial impact of these access line losses is heightened by the fact that Iowa Telecom, like other rural ILECs, is highly dependent upon the revenues generated from a small number of its largest business customers. CLECs, naturally, have targeted these key customers, with considerable success.

Moreover, competition is becoming increasingly significant. Six new CLEC competitors, including a municipal CLEC and four other CLECs that plan to overbuild Iowa Telecom's network, have received approval from the IUB to offer local exchange service and will bring competition to ten additional exchanges in the near future. In addition, more than a dozen other CLECs, including two municipal CLECs, have obtained certificates of public convenience and necessity to offer local exchange services in Iowa Telecom's service territory. Many have already filed tariffs with the IUB for intrastate services. Competition from these new sources will inevitably lead to further significant losses of market share, with the associated negative impact on Iowa Telecom's per-line revenues and costs.

V. THE ATS TARGET RATE IS TOO INFLEXIBLE AND PREVENTS IOWA TELECOM FROM GENERATING SUFFICIENT REVENUES TO FUND NECESSARY INVESTMENTS

Existing federal regulations are not flexible enough to permit Iowa Telecom to achieve reasonable access revenues to cover needed improvements in its network as outlined above. The ATS target rate is unreasonably low as applied to Iowa Telecom's circumstances. If the Commission had provided a meaningful opportunity at the time that CALLS was implemented for Iowa Telecom to choose between the ATS target rate and forward-looking cost options, it could have realistically selected an approach that would work for it. But the 60-day rule has foreclosed the forward-looking cost option to Iowa Telecom, absent the Commission's grant of this Petition.

Iowa Telecom does not endorse the use of Total Element Long Run Incremental Cost ("TELRIC") generally, or the Synthesis Model in particular, to establish interstate access rates. Nevertheless, it is presenting data derived from the Synthesis Model in this Petition because the

Synthesis Model is the mechanism for calculating cost-based rates that the Commission has adopted through notice and comment rulemaking.

A. Iowa Telecom Seeks a Meaningful Opportunity to Make the Voluntary Election Afforded Other ILECs in July 2000

As described in detail in Section I, Iowa Telecom selected price cap regulation in the Spring of 2000, when it believed that it would be able to operate under the then-existing price cap rules. It understood that CALLS would be optional, and therefore it would not have to comply with CALLS, including the ATS target rates. It did not know until May 31, 2000, that it would be forced into a Hobson's choice: either select CALLS or justify rates based on a forward-looking cost study. Given that Iowa Telecom did not actually begin operations until July 1, 2000, was focused entirely on beginning operations, did not have the technical capability to evaluate the impact of a forward-looking cost study at that time, and was faced also with the industry understanding that forward-looking costs produced lower rates, the company had no realistic choice but to opt into CALLS. It was not until it had operated for a year, and could evaluate first-hand what improvements were necessary, that it could make a reliable business decision on how to proceed.

Iowa Telecom requests forbearance from the 60-day rule so that it will have the opportunity to make a voluntary election. As discussed above, Iowa Telecom received no such meaningful opportunity due to Iowa Telecom's nascent state of operations during the 60-day window permitted under the *CALLS Order*. Forbearance from this rule would allow Iowa Telecom to elect to price access services at TELRIC and grant it relief from the strictures that the