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

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| In the Matter of | ) | |
| | ) | |
| Federal-State Joint Board on Universal | ) | CC Docket No. 96-45 |
| Service Seeks Comment on Certain of the | ) | FCC 04J-2 |
| Commission's Rules Relating to High-Cost | ) | |
| Universal Service Support | ) | |

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**Summary of Comments**

GVNW supports the continued use of the statutory definition of "rural" as contained in Section 3(37) of the Communications Act for the administration of the Universal Service Fund. Any changes to the current rules for rural carriers must ensure that support mechanisms remain specific, predictable, and sufficient.

GVNW believes that the current method of providing support based on embedded costs is appropriate and has provided appropriate incentives to invest in network infrastructure.

The RTF report provided analysis demonstrating that using the non-rural support mechanism for calculating support for rural carriers would cause dramatic reductions in the support available to rural carriers. The RTF Recommendation provided substantial evidence of the inadequacy of the Synthesis Model to develop appropriate forward-looking costs for rural carriers. Little has changed in the model since that analysis was completed to address the concerns expressed. Attempting to address issues necessary to evaluate whether a forward-looking model could produce meaningful results would involve extensive efforts.

One of the options available to the Commission to address the precipitous increase in support fund levels due to CETC support would be to shift CETCs to a method of drawing support based on their costs of providing infrastructure.

We recommend that the high-cost loop mechanism not be merged with local switching support. We also recommend that the Commission clarify the administrative issues related to its current rules on the implementation of safety valve support.

Introduction and Background

GVNW Consulting, Inc. (GVNW) is a management consulting firm that provides a wide variety of consulting services, including regulatory support on issues such as universal service, advanced services, and access charge reform for communications carriers in rural America. The purpose of these comments is to respond to the Public Notice that was issued as FCC 04J-2. In this proceeding, the Joint Board has requested comments on issues relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanisms to succeed the five-year plan adopted by the Commission in its Rural Task Force Order[1].

The overarching principles that the Joint Board should consider in this proceeding are found in Section 254 of the Telecommunications Act of 1996 (1996 Act). Specifically, any changes to the current rules for rural carriers must ensure that support mechanisms remain specific, predictable, and sufficient. Consumers in rural areas of the country must continue to have access to telecommunications and information services that are reasonably comparable in scope and rates to the options available in urban areas. In addition, services offered to rural carriers must be available at just, reasonable, and affordable rates. Federal universal service support mechanisms are an important component in meeting such a requirement.

[1] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (2001) (Rural Task Force).

DEFINITION OF "RURAL" FOR UNIVERSAL SERVICE PURPOSES

Rural Definition Issues

GVNW supports the continued use of the statutory definition of "rural" as contained in Section 3(37) of the Communications Act for the administration of the Universal Service Fund. We believe that a common definition will reduce confusion and result in more consistent administration of the Fund.

GVNW does not support making a finer distinction between small, medium, and large rural companies. Once the company has been identified as rural, the support mechanism should continue to use "actual" cost based on the embedded cost of the recipient. We believe this to be the best method for providing support to rural carriers because it more precisely provides support in relation to the cost associated with providing the service. We believe that the more companies are treated on a "hypothetical cost" basis rather then an actual cost basis, the more likely the company will either receive a windfall causing a drain on the fund, or will be under compensated which will fail to fulfill the statutory mandate that the funds are predictable and sufficient.

Study Area and Holding Company Issues

GVNW does not believe it is appropriate to change the current treatment of companies with multiple study areas within a state. If a company has some study areas that are in competitive areas and have lower costs, they should not be combined with the higher cost study areas as this would result in the high cost areas support being diluted to subsidize the lower cost study areas. The loss of support to the high cost area would also be magnified by the mechanics of the computation where the sum of the combined study area support would likely be less then the sum of the individual areas computation.

We do not believe it would be appropriate to change the Universal Service procedures to recognize the differences in economies of scale and scope based on the Rural Carriers holding company size. If a holding company has advantages related to economies of scope and scale, these benefits should be passed on to the individual study areas through lower costs, which are already being recognized in the cost based mechanism. If there is a perception that a holding company is not passing on these benefits, this should be addressed on an individual company basis through a review of the costs that are passed on to the individual operating units from the headquarters operations.

While we do not believe the holding company size should be relevant in the scope of a global definitional context, we do believe that the current recognition of study area size with regard to the Local Switching Support is appropriate. While we believe that a more equitable method of supporting the high cost of switching in rural areas could theoretically be developed, we believe that the Commission did a good job in balancing the administrative burden of having a more precise system with the equity of having a more simplified approach based on study area size. We believe the balance is appropriate and should not be changed without a thorough investigation and analysis.

With regard to the High Cost Loop fund, we believe the that high cost rural areas may get support on the same bases as low cost urbanized areas meeting the rural criteria, but this should not be confused with either area getting an inappropriate amount. If the area is a low cost urbanized area, the cost based mechanism for High Cost Loop support would use these low costs in the determination if they are entitled support, and if they are

low cost, they will not get support. The cost based mechanism is the appropriate mechanism for making this determination.

Issues regarding Economies of Scale

GVNW does not believe the current rules discourage consolidation to achieve economies of scale and scope. If there is truly the ability to achieve economies of scope and scale, the companies will likely consolidate operations to achieve this even though they don't combine their study areas for reporting purposes. This allows them to have the lower costs to pass on to each study area, without disrupting the pricing and recovery flows associated with divergent serving areas.

If a new definition of "rural" is adopted by the Commission, we do not believe that support for rural companies should be moved or transitioned to the non-rural method for determining HCL support without carefully considering the impacts and ramifications of such a change. As discussed in greater detail below, the Rural Task Force clearly illustrated that the non-rural HCL method including use of forward-looking models and average state benchmarks would have significant impacts on individual rural companies. Any change in the method for determining support for all or some subset of rural companies could have significant impacts on those companies which would have to be carefully evaluated in regard to the sufficiency of support that would be provided.

UNIVERSAL SERVICE SUPPORT IN AREAS SERVED BY RURAL CARRIERS

We agree with the Joint Board that in reviewing the basis for providing HCL support to rural companies that careful attention needs to be given both to cost basis for support and to the method for calculating support. The analysis presented by the Rural Task Force in White Paper #4 regarding the application of the then current non-rural method for determining support to rural companies provides a clear starting point for evaluating these two issues separately. The RTF analysis identified that support for rural telephone companies would drop from $1,553 million to $451 million by applying the non-rural method including both forward-looking costs and the use of the statewide average for determining what states and companies would receive support.

However, the RTF further demonstrated that if forward-looking cost models were used to develop the cost levels, but that the study-area method was used to determine support rather than the state-wide average, that at the 135% benchmark of the national average cost, total support for rural companies would be $3.4 billion rather than the $451 million that resulted from use of statewide average costs. This analysis gives a clear indication of the importance of both the cost basis of support and the method for calculating support in the overall determination of support levels. [2]

[2] See A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies, Rural Task Force White Paper 4, September 2000, pages 13-19 with particular attention to the table on Page 16 that shows that support for rural companies would drop from $1,553 million to $451 million if the non-rural high cost loop method was applied to rural companies. Furthermore, examination of Page 2 of Appendix D to White Paper #4 shows that the number of states (and other jurisdictions) where rural companies would receive support would plunge from 51 to just 15.

COST BASIS OF SUPPORT – EMBEDDED VS. FORWARD-LOOKING COSTS

Some commenters will undoubtedly continue to extol the "virtues" of the use of forward-looking economic costs based on economic theories. However, such comments in the past have generally ignored the underlying assumptions of such theories that forward-looking costs can be correctly and economically determined. To the extent that this is not the case in the real world, the basis for the economic arguments crumbles and proper incentives are not given by hypothetical, but incorrect, forward-looking costs. As the RTF clearly reflected in its report, the Synthesis Model is not a sufficient tool for accurately developing forward-looking costs for rural carriers. Thus, one cannot assume that support based on such a model would provide the theoretically correct incentives for investment espoused in economic theory.

In judging the appropriate incentives to invest in the network, one should ask what method is likely to provide the greatest incentive to invest, a method that provides support based on hypothetical costs and models regardless of whether the investment is actually made and the network is actually built, or a method that provides support based on actual network investment and expenses that have been incurred and a network that is actually built and in service. GVNW believes that the latter method provides a much clearer incentive to invest in and build network infrastructure. We further believe that the use of this method prior to the and subsequent to the RTF Order has provided an actual demonstration of these incentives.

The underlying infrastructure for the provision of advanced services using wireline facilities is an upgraded wireline network with fiber fed digital loop carrier

technology and copper loops short enough to avoid the need for load coils and loop extenders. This network provides both improved voice communications and the underlying structure necessary to support the deployment of advanced services. A review of various reports on the deployment of broadband services in rural areas shows clear evidence that, in fact, this underlying network infrastructure is being built in the operating areas of rural carriers, with a consequent ability to deploy advanced services in these areas. The current method of providing high cost loop support to rural areas is clearly providing incentives to deploy a network capable of providing advanced services.

## COST BASIS OF SUPPORT – FORWARD-LOOKING MODELS

In assessing the viability of using forward-looking cost models for the determination of High Cost Loop (HCL) USF support, the Commission should carefully review the analysis performed by the Rural Task Force (RTF) of the FCC's Synthesis Model as documented in the RTF's White Paper #4, "A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies".[3] The RTF devoted extensive resources to reviewing the Synthesis Model in relationship to the results it produces for rural companies and documented that analysis in White Paper #4. The analysis include the development of a set of criteria contained in Appendix B of White Paper #4 that provides the basis that the RTF used in evaluating the Synthesis Model and its results and documentation of the results of the analysis against

[3] A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies, Rural Task Force White Paper 4, September 2000.

those criteria. Based on its substantial evaluation of the Synthesis Model using these criteria, the RTF concluded:

> The aggregate results of this study suggest that, when viewed on an individual rural wire center or individual Rural Carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. In fact, much of the data analysis suggests that the model results tend to be in the high and low extremes, rather than near the expected results for the area being analyzed. While it may be technically possible to construct a model with added precision and variables to account for the differences among Rural Carriers and between non-Rural Carriers and Rural Carriers, it is the opinion of the Task Force that the current model is not an appropriate tool for determining the forward-looking cost of Rural Carriers.[4]

In evaluating the conclusion of the RTF in regards to the Synthesis Model, one should ask, "What has changed in the mean time that would alter this conclusion?" If one reviews the current version of the Synthesis Model in relation to the version that the RTF evaluated, one can quickly conclude that in regard to the model itself, very little has changed in the ensuing years.[5] While there have been minor modifications in the Synthesis Model since that time, there has been no substantive review or modification to the model to address the wide variety of concerns documented by the RTF in its Report. No effort has been made to modify inputs or to add to the flexibility of the Synthesis Model to address the substantial concerns identified by the RTF. One can therefore reasonably assume that should such an analysis be conducted today, similar concerns regarding the validity of the Synthesis Model as a tool for estimating forward-looking costs would be equally apparent.

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[4] A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies, Rural Task Force White Paper 4, September 2000, page 10.
[5] As shown in "History" document contained on the FCC website at http://www.fcc.gov/wcb/universal_service /

It also must be recognized that external factors have continued to change over time, raising further questions regarding the validity of the current version of the Synthesis Model and its inputs as a forward-looking cost tool. These include:

1. The underlying census block and household data that form the basis for estimating customers and household counts was based on 1990 census data updated to the mid-1990's, data that is now approaching ten years old.

2. The underlying road network information that is used to estimate customer locations is similarly nearly ten years old.

3. The penetration of wireless service for use as an alternative voice communications device and as a substitute for landline service has increased substantially outdating assumptions regarding traffic usage and customer density on wireline networks. No consideration is given in the model to the networking implications of traffic originating to or terminating from wireless carriers, particularly traffic terminating on an intraMTA basis.

4. Networking changes reflecting changing host/remote and end office/tandem relationships need to be updated.

5. Company ownership and study area changes and consolidations have taken place, changes that are not reflected in the model.

6. Cost inputs are based on data and technology that is several years old and may not reflect current labor and material costs or technology.

7. Regulatory changes such as the implementation of intraLATA presubscription, acceptance of virtual NXX in some jurisdictions, and local number portability are not

reflected in trunking, tandem switching, and other interoffice network cost determinations.

8. In view of the increase in competition from both facilities based and wireless carriers in the years since the model was developed, and the potential increase in competition from internet based services and possibly electric company competitors, the underlying assumption of a single-provider cost based network may also need to be readdressed.

In summary, in order to implement a reasonable forward-looking cost model that is applicable to rural companies, a massive undertaking to update the model to reflect the cost differences of rural companies, from non-rural companies and from each other, to address the concerns raised by the RTF in its Report, plus a full-update of model inputs to reflect changes since the model inputs were developed and to address rural vs. non-rural cost differences would be necessary, at a minimum. Whether such an effort would result in a model that would give predictable and sufficient measures of USF support could only be determined after such an undertaking is completed.

## THE BASIS OF SUPPORT FOR COMPETITIVE ELIGIBLE TELECOMMUNICATIONS CARRIERS (CETCs) POSES SEVERAL INTERESTING CHALLENGES

Few parties in the industry dispute that one of the foundational bases of federal universal service support is to facilitate infrastructure investment in networks that enables carrier(s) to provide ubiquitous service to customers. However, a key point of contention is on what basis the level support should be determined for competitive carriers that have achieved eligible telecommunications carrier status in a state.

An interesting threshold comparison is to contrast what each group of carriers are, or in some cases are not; doing or providing after the certification has been granted. Stated differently, in examining whether it is equitable to provide portable support to CETCs based on ILEC costs, one should examine whether similar requirements are imposed or in place, which in turn determines how end-user customers are impacted.

While perhaps not the express intent of the states, the apparent desire for competitive choice has created several notable differences: differences in ubiquity, differences in services provided, and differences in service standards. While rural ILECs have ubiquitous infrastructure in place in order to serve remote and high-cost customers, CETCs in many cases are not required to provide ubiquity at the time of their certification. In addition, CETCs in some cases are permitted to become certificated in a much smaller geographic area than the ILEC. In some states, CETCs are not required to meet the same service quality and reliability standards as is required of the ILEC provider. In sum, the CETC may face significantly fewer obligations and expectations, while being eligible under current rules for the same level of support as the ILEC that faces a more stringent set of requirements and concomitantly higher costs.

Is such a result equitable?

A review of the record developed to date in both federal and state proceedings indicates that one's view of equity is influenced primarily by whether one is an ILEC providing ubiquity or a CLEC meeting less stringent standards. Fortunately, we have reached the point in the regulatory timeline that judicial review has now begun to pass judgment on certain of the decisions reached to date. One notable recent decision is found in a District Court decision in Kansas (In the District Court of Nehama County, Kansas, *Bluestem Telephone Company. et al v. Kansas Corporation Commission)* where the court reached a decision that competitive neutrality had been violated by providing CETCs with ILEC cost-based support and permitting different levels of cost justification.

What are the impacts on the current fund levels of such an approach?

Another key variable in this instant review is the impact that existing policies have on the total level of universal service funding. In this regard, it is revealing to examine data available from the most recent fund size projections from the Universal Service Administrative Company (USAC) that empirically demonstrate that CETCs are the driver in the growth of support payments. A comparison of data found in USAC Appendix HC01 between the 4Q of 2003 and the 4Q of 2004 shows that just over 70 percent of the growth in fund size is attributable to CETCs [$56.3M out of a total of $79.8M in annual support increase]. Thus, if the Joint Board and Commission determine that such a rate of growth is not sustainable; both parties are faced with an interesting set of decisions. Choices with regard to CETC eligibility are being reviewed in a separate Commission proceeding. Any changes to the costing basis for CETC support could create a lengthy proceeding for both the Joint Board and the Commission.

Options available to the Joint Board and Commission

One of the options available to the Commission to address this precipitous increase in support fund levels would be to shift CETCs to a basis of drawing support based on their costs of providing infrastructure. Such an approach would require bringing the CETCs under the same rules, standards, and enforcement mechanisms as the ILECs.

Such an effort would be a considerable task, and might necessitate some type of interim mechanism while new procedures are formulated. In such an interim period, the Joint Board and Commission could consider either of the following two options.

First, an interim mechanism could be established that would provide an "average schedule" like mechanism for CETC support levels. This approach could enable a CETC to choose between submitting a cost study or to opt for a set of formulas that would approximate the embedded costs of similarly situated carriers. Such a choice could be considered necessary in order to provide a CETC with a competitively neutral choice, as any ILEC had the option at some point in time of choosing average schedules versus a cost basis of settlement.

Another alternative that could be used as an interim mechanism is the plan that was filed August 6, 2004 by the Rural Telecommunications Associations (OPASTCO, RICA, and RTG) in CC Docket No. 96-45 in the Commission's proceeding on the Joint Board's Portability Recommended Decision. This RTA proposal establishes a "safe harbor" percentage of the rural ILEC's per-line support amount. The percentages proposed by the RTA plan are predicated on the relative cost difference between wireline and wireless carriers based on current data, and seek to reflect the fact that large wireless

carriers serve predominantly urban areas that requires less support than smaller, rural wireless carriers.

In sum, if the Joint Board and Commission desire to achieve a competitively neutral regulatory environment, we respectfully submit that a choice must be made. Either the differences outlined at the beginning of this section should be addressed, or steps should be undertaken to place CETCs on a basis of support that reflects their costs of providing infrastructure.

## CALCULATION OF SUPPORT

### Rural is still different

In its series of white papers, the Rural Task Force issued its Second White Paper entitled "Rural is Different" nearly four years ago, which detailed empirically the differences between urban and rural areas, as well as differences amongst the rural subset of carriers.

In the fourth quarter of 2004, rural is still different. What does this mean for a review of the basis of calculating rural carrier universal service support? Simply stated, the prescription to keep rural areas healthy is to continue the principles that serve as the foundation of the earlier Rural Task Force rules. First, the Commission should continue to calculate rural carrier high-cost support based on individual carrier study area average costs. This approach has provided appropriate incentives for prudent investment in rural infrastructure. Second, the Commission should continue to use the current 11.25 percent authorized interstate rate-of-return for calculating rural ILEC universal service support. Third, the Joint Board and Commission should reject once and for all the proposal to

calculate rural carrier support on the basis of statewide average costs. The Rural Task Force detailed the deleterious impact this would have on rural carrier support funding. The Joint Board has recognized, subsequent to the implementation of the RTF rules, the problems associated with statewide averaging for rural carriers in its October, 2002 Non-Rural Recommended Decision, stating in part that statewide averaging "may not be appropriate for the high-cost mechanism providing support to rural carriers."

Local Switching Support should not be combined with High Cost Loop Support

We recommend that the high-cost loop mechanism not be merged with local switching support. The mechanisms are intended to address separate issues that face small, rural carriers and should remain discrete. This is different than the recent combining of Long-Term Support (LTS) with the Interstate Common Line Support (ICLS) mechanism, as those two items addressed similar costs. While in many situations carriers that have high loop costs also have relatively higher switching costs, it is not always the case. In order to meet the needs of all rural customers, separate mechanisms should continue to be maintained.

Rural carriers have relatively high loop costs because of the lack of economies of scale and density. The purpose of the high-cost loop support mechanism is to provide support for companies with High Loop Costs by shifting costs from Local to the interstate Jurisdiction. The procedures for this mechanism are contained in the Part 36 Jurisdictional Separations Rules. The costs that are shifted to interstate are assigned to access. Initially these access costs were recovered through a per minute charge to Interexchange carriers (IXCs). Later the costs were recovered through per line charges to the larger IXCs. Currently these costs are recovered from the Universal Service Fund.

Rural carriers frequently have fewer lines per switch than do non-rural carriers, providing fewer customers over which to spread high fixed network costs. The purpose of the local switching support (LSS) is to provide explicit support for small study areas. The separations rules made provisions for additional assignment of switching costs to the interstate jurisdiction for study areas with less then 50,000 access lines. The LSS mechanism was intended to provide a separate computation that would allow the ILEC to get recovery of a significant portion of this additional interstate allocation from the Universal Service Fund rather than through access rates charged to the IXCs.

SUPPORT FOR TRANSFERRED EXCHANGES SHOULD BE MAINTAINED

As stated in paragraph 48, the safety valve mechanism enables rural carriers acquiring access lines to receive additional high-cost loop support to account for post-acquisition investments made to enhance the infrastructure of and improve the service in the acquired exchanges.

While the comment above seems to imply the support for acquired lines, in practice the rules and the order supporting the adoption of the rules are so confusing, that the companies that made acquisitions back in the year 2001 are still not receiving the support in accordance with the rules.

The primary confusion stems from the two year lag period between the "data period" and the "expense adjustment period". Under the current rules as administered by NECA, the calculation of the expense adjustment is prescribed in Part 36.631. This expense adjustment is calculated per the data gathered under Part 36.611 or optionally under Part 36.612. Using Part 36.611, the start of the calendar year for which the data is

gathered is a full two years prior to the start of the calendar year for which the expense adjustment and related support is received. Using the Part 36.612 optional procedures, the lag time can be cut to one year and nine months.

Part 54.305 clearly indicates that the "index period expense adjustment" is calculated for the first year after the acquisition. Using Part 36.611 procedures, this would be the first calendar year after the acquisition. In case of a 2001 acquisition, the "index period expense adjustment' would be calendar year 2002. The company would then be qualified for the safety-valve support in the first subsequent year after the acquisition, in this case 2003. The administrators of this fund have indicated that they believe the first year after the acquisition is the data period i.e. 2002 becomes the data period for which the index period expense adjustment is calculated making 2004's expense adjustment the "index period expense adjustment". This means that 2005 becomes first subsequent year's expense adjustment qualifying for the safety-valve support.

We do not believe it was the Rural Task Force's intent or the FCC's intent in adopting the Safety-Valve rules to have a mechanism that doesn't kick in until three plus years after the acquisition. This interpretation/administration of the rules results in an acquisition completed before the RTF rules went into place generating its first payment in the last full year of the five year plan.

If it was the FCC's plan to eliminate the two-year lag period currently contained in the Part 36 rules, we ask that the Commission change the Part 54.305 rules to clearly remove this lag. In the alternative, if it is the Commission's desire to apply the lag as it is currently administered under Part 36, we ask that the Commission reinforce its intent that

the first full year after the acquisition is the proper period for the "index period expense adjustment".

Another area of confusion is the application of the quarterly update process in developing the "index period expense adjustment" and in the development of the "subsequent periods expense adjustments".

Currently Part 36.612 is administered by using the quarterly update information for determining support for the remaining portion of the calendar year for which it was calculated. When the required annual filing under Part 36.611 is made, the new amounts are used for the beginning of the next calendar year. For example, if a company files the optional data on March 30, 2004 following the Part 36.612(a)(3) rules, the data that is submitted is for the period October 1, 2002 through September 30, 2003. This establishes the expense adjustment amounts that are paid from July 2004 through December 2004. Starting in January 2005 the expense adjustment will be calculated using the 2003 annual data that was submitted on July 31, 2004.

There is a belief among the NECA/USAC administrative staff that the quarterly update process for the safety-valve administration should be handled differently. They believe that the quarterly update filing should be administered for a full year rather than the remaining portion of the applicable year as described above. We are currently not aware of any rule or order that would justify this disparate treatment and we ask that if the Commission did intend a different application of the 36.612 rules for safety-valve purposes, it clarify this different treatment through a rule change.

We recommend that the Commission clarify this misconception of the administrators and retain section 54.305.

Respectfully submitted

Via ECFS on 10/15/04

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