

TABLE OF CONTENTS

Summary.....	ii
COMMENTS OF INTERSTATE TELCOM CONSULTING, INC.....	1
I. Interstate Telcom Consulting, Inc.....	3
II. Encouragement of Investment Is Primary Goal.....	4
III. An Embedded Cost Mechanism Provides Investment Incentives	
Far Superior to Those of a Forward-Looking Economic Cost Mechanism.....	8
A. Assurance of Cost Recovery Is Essential for Rural Network Investment.....	8
B. The High Cost Fund Has Become the Primary Rural Cost Recovery Mechanism.....	9
C. The Existing Embedded Cost Mechanism Encourages Rural Network Investment.....	10
D. FLEC Mechanisms Discourage Rural Network Investment.....	13
IV. “Rural Carriers” Should Not Be Redefined for Universal Service Purposes... ..	15
V. High Cost Support Should Be Determined and Calculated on a Network Basis... ..	17
VI. CETCs Should Receive High Cost Support on the Basis of Their Own Embedded Costs.....	19
VII. Conclusion.....	21

SUMMARY

Interstate Telcom Consulting, Inc. (“ITCI”) recommends that the Joint Board and the FCC evaluate all potential High Cost Fund mechanisms on the basis of their ability to encourage investment in rural telecommunications networks. This is the approach that best complies with the dominant pro-investment goal of the 1996 Act and its universal service provision.

If the Joint Board and FCC properly focus upon incentives for investment, they will retain embedded costs as the most effective federal high-cost support mechanism that can be employed for rural carriers during the foreseeable future. ITCI submits that the existing embedded cost mechanism has furnished the assurances of cost recovery necessary to produce reasonable and prudent investment by rural telephone companies in their rural networks during the past two decades. The proven record of success of the existing embedded cost mechanism as an incentive for rural network investment mandates its retention as the basis for determining and calculating high-cost support for all rural telephone companies as well as its use for the same purposes with respect to competitive eligible telecommunications carriers (“CETCs”).

In contrast, forward-looking economic cost (“FLEC”) mechanisms are devoid of any inherent incentive to promote investment in high-cost areas. Rather, most FLEC mechanisms discourage rural network investment because they focus upon the costs that carriers will incur in the future to construct and maintain theoretical efficient networks, and preclude carriers from recovering their actual investment dollar outlays if equipment prices decrease or if technological changes produce less expensive alternatives.

The Joint Board and FCC should not re-define “rural telephone company” or “rural carrier” to remove larger or medium-sized rural telephone companies from the embedded cost mechanism, or to limit or reduce their high-cost support. The existing embedded cost mechanism has been much more successful than the FLEC mechanism imposed upon non-rural carriers in encouraging the upgrade and modernization of rural telephone exchanges. Large and medium-sized rural telephone companies should not be saddled with an ineffective or anti-investment mechanism, and their rural customers should not be deprived of the upgrades necessary to provide them with high quality, affordable and reasonably comparable services.

Finally, CETCs should be furnished high-cost support on the basis of the embedded costs of their own investments in the actual networks that they serve. If they wish to receive substantial amounts of high-cost support, they should be required to implement the accounting standards and cost reporting procedures necessary to determine and verify their costs and related support.

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

In the Matter of)
)
Federal-State Joint Board on) CC Docket No. 96-45
Universal Service)

TO: The Federal-State Joint Board on Universal Service

**COMMENTS OF
INTERSTATE TELCOM CONSULTING, INC.**

Interstate Telcom Consulting, Inc. ("ITCI") hereby submits its comments in response to the Public Notice (Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support), FCC 04J-2, released August 16, 2004.

ITCI believes that the federal high-cost support mechanism adopted in this proceeding must be the one that best encourages investment in rural telecommunications networks. The provision of appropriate and effective incentives for investment in telecommunications networks was the primary goal of both the Telecommunications Act of 1996 and its Universal Service provision (47 U.S.C. Sec. 254).

ITCI is convinced that the embedded cost mechanism provides the most efficient and effective investment incentives for rural telephone companies and other small rural carriers. The embedded cost mechanism is based upon each carrier's actual investment outlays, and provides the accurate and direct assurance of cost recovery that is necessary to convince small carriers and their lenders to invest in rural networks. In contrast, FLEC models and mechanisms are complex and uncertain at best, and appear biased against full investment cost recovery in the common instance where technological and/or economic

changes result in theoretical “equipment cost” decreases after investments are made. The existing embedded cost mechanism has encouraged reasonable and prudent investment in rural telecommunications networks, whereas FLEC mechanisms will discourage such investment.

ITCI’s clients are small rural telephone companies that serve less than 21,000 lines. Nonetheless, ITCI does not believe that the terms “rural telephone company” and “rural carrier” need to be re-defined, particularly as a means to reduce or eliminate high-cost support for larger or medium-sized rural telephone companies. The previous 1997 bifurcation of high-cost support mechanisms between rural carriers and non-rural carriers has not produced adequate investment by non-rural carriers in the upgrade or modernization of many of their rural exchanges. There is no reason to extend the problems of insufficient investment to customers of larger and medium-sized rural telephone companies by re-defining their status or by replacing the existing, successful embedded cost mechanism with a FLEC or proxy mechanism that does not encourage rural network investment.

High-cost support should be determined and calculated on the basis of networks. Carriers invest in, construct, operate, maintain, upgrade and administer networks; and not lines or wire centers. Likewise, customers take service on networks so that they can communicate with people who are reachable via their network and/or who connect with other networks.

Finally, competitive eligible telecommunications carriers (“CETCs”) should receive high-cost support on the basis of the embedded costs of their own networks that serve rural or other high-cost networks. Given the purpose of high-cost support to

encourage investment by assuring recovery of investment costs in rural and other high-cost areas, each eligible telecommunications carrier (“ETC”), including each CETC, should receive support solely on the basis of its own actual investments in its own network.

I.

Interstate Telcom Consulting, Inc.

ITCI is a telecommunications consulting firm located in Hector, Minnesota. Its five principal employees have over 145 years of collective experience in the telecommunications industry. ITCI has served rural telephone companies continuously since it commenced operations in April of 1981. ITCI performs a variety of telecommunications consulting services for rural telephone companies, including cost separation studies, revenue forecasting, access tariff development, depreciation studies, continuing property record maintenance, traffic engineering and analysis, Carrier Access Billing System (“CABS”) billing and reviews, long distance consulting, National Exchange Carrier Association (“NECA”) reporting, average schedule settlements, access service requests (“ASRs”), AOCN services, SOA services for local number portability, circuit provisioning, business plans, and exchange acquisition assistance.

ITCI’s rural telephone company clients range in size from approximately 40 access lines to approximately 20,500 access lines, and are located primarily in the states of Minnesota, Wisconsin, Michigan, Iowa, South Dakota, Ohio and Montana. A list of the seventy rural telephone company clients that ITCI is representing in this proceeding is attached.

II.

Encouragement of Investment Is Primary Goal

High-cost support mechanisms and alternatives should be analyzed and compared predominately on the basis of their ability to encourage investment in essential telecommunications networks in rural, insular and other high-cost areas.

The encouragement of investment in telecommunications networks was the overriding goal of the Telecommunications Act of 1996. The Conference Report for the statute (H. Rept. 104-458) explicitly declared that the pro-competitive, deregulatory national policy framework of the Act was "designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans." 142 Cong. Rec. H1078 (January 31, 1996).

During the mid-1990s, the Clinton Administration and Congress wanted the public switched telecommunications network to be upgraded to accommodate the new voice, data and video services made possible by advancing technology. However, budget deficits and political constraints prevented the use of public tax dollars for telecommunications infrastructure investment. The statutory solution was to encourage investment in telecommunications networks by reducing regulation and by promoting competition among entities in the converging local telephone, long distance telephone, cable television and computer industries.

In urban and suburban areas, the 1996 Act was designed to encourage private sector investment in telecommunications networks, particularly state-of-the-art networks capable of delivering advanced telecommunications and information services in addition

to traditional telecommunications services. However, in rural areas, airline service losses by many rural communities as a result of airline deregulation and competition raised concerns that similar telecommunications service losses could occur. Therefore, Congress added the universal service provisions of Section 254 as a "safety net" for rural and other high-cost areas where competition might not develop or where it might not produce the desired network investment and service.

The High Cost Fund provides the assurances of cost recovery necessary to encourage investment in telecommunications networks in rural and other high-cost areas. Given the high costs, small populations and lack of scale economies in rural areas, it is neither prudent nor financially feasible for owners and lenders of many rural carriers to invest in capital-intensive telecommunications networks unless they have assurance that they can recover their investment costs.

Sufficient and timely investment in telecommunications networks is essential for the provision of "quality services" at "just, reasonable and affordable rates" in rural and other high-cost areas. See 47 U.S.C. Sec. 254(b)(1). Adequate investment is also required if consumers in rural, insular and other high-cost areas are to have access to telecommunications and information services reasonably comparable to those provided in urban areas at rates reasonably comparable to those in urban areas. See 47 U.S.C. Sec. 254(b)(3).

Telecommunications investment also produces local jobs and economic development that are essential for the survival and viability of many rural communities. The economic stimuli of rural networks and infrastructure investment not only provide the physical networks over which services are provided, but also enable households and

small businesses in high-cost areas to afford telecommunications services and to participate more fully in the economy and society of the 21st Century.

The purpose of the High Cost Fund is not now, and has never been, to promote competition. Rather, as noted above, competition was one of the “means” employed by the 1996 Act to achieve its goal of encouraging investment in telecommunications networks. In rural and other high-cost areas where competition has not developed or where competition discourages investment by splintering limited customer and revenue bases that are too small to permit multiple carriers to recover the costs of constructing capital-intensive networks, the High Cost Fund must bear the principal burden of encouraging reasonable and prudent network investment.

The Joint Board and the Commission may consider and determine, in this proceeding or in a later docket, whether the High Cost Fund should encourage investment in one network or multiple networks in high-cost service areas. However, regardless of the number of networks supported, the purpose of the High Cost Fund remains to encourage investment in such network(s).

Finally, the recent growth in the size of the Universal Service Fund (which includes the Schools and Libraries Fund, the Rural Health Care Fund, the Access Universal Service Fund and other mechanisms in addition to the High Cost Fund) is cause for legitimate concern. However, the purpose of any new or modified High Cost Fund mechanism must be to encourage network investment and not to minimize Fund disbursements. The making of sufficient and timely network investments avoids service, quality and economic losses from degenerating network facilities, and is the most cost-effective solution to universal service issues in the long run. It also eliminates expensive

catch-up investment projects programs like those that have been undertaken by many rural telephone companies to upgrade rural exchanges acquired from non-rural carriers that had been neglected for many years.

There are several options available for controlling the growth of the High Cost Fund. First, as ITCI has previously proposed in the “portability” segment of this proceeding, carriers requesting designation as eligible telecommunications carriers (“ETCs”) should be required to demonstrate that the new network investment and other concrete service, service area, service quality and rate benefits resulting from their designation will outweigh the additional portable high-cost support outlays and other costs thereof. In addition, ITCI proposed that all wireline and wireless ETCs be subject to the same competitively neutral carrier of last resort obligations, service quality standards and rate regulation. Second, the FCC needs to preserve reasonable revenue streams for access cost recovery and other forms of intercarrier compensation, and terminate its practice of transferring billions of dollars of cost recovery from interstate access charges into the High Cost Fund. Third, the Joint Board and FCC should stop allowing wireless CETCs to receive substantial amounts of portable high-cost support in excess of their own actual costs. CETC’s should no longer be able to receive “portable” high-cost support in rural telephone service areas based upon rural telephone company costs when the major portion of their networks and customer bases are located in low-cost urban and suburban areas.

In sum, the primary focus of this proceeding must be the encouragement of investment in telecommunications networks in high-cost areas.

III

The Existing Embedded Cost Mechanism Provides Investment Incentives Far Superior to Those of a Forward-Looking Economic Cost Mechanism

The existing embedded cost mechanism of the High Cost Fund is far superior to the FLEC mechanism in providing the assurance of cost recovery necessary to encourage rural network investment.

A. Assurance of Cost Recovery Is Essential for Rural Network Investment

Investment decisions are made by balancing prospective rewards against likely risks. In urban markets, both customer bases and potential profits are large; therefore, some entities will invest in projects with large possible pay-offs even if there is a significant risk that they will not recover their costs. However, in rural markets where both customer bases and potential profits are much smaller, prospective investors and their lenders will accept much less risk and require much greater assurance that investment costs will be recovered.

This general risk-reward difference between urban and rural investment is much more pronounced with respect to investment in capital-intensive telecommunications networks. All telecommunications networks require expensive switches, distribution facilities, connections to other providers, and administrative systems, whether they are urban or rural, wireline or wireless. The minimum costs of such networks pose a much higher hurdle with respect to rural networks because they serve smaller customer bases and lack of economies of scale. Moreover, distribution facilities (e.g., customer loops and cellular towers) and inter-office facilities (e.g., trunks and microwave paths) are much more expensive in both relative and absolute terms in rural areas because of the

great expanses of territory they must cover, as well as the rugged terrain and harsh climates in which they must be constructed, operated and maintained. As the FCC noted in its MAG Order, a loop in a mountainous and sparsely populated Wyoming wire center may cost an estimated \$866.27 compared to an estimated \$9.97 cost for a loop in a New York City wire center.¹

B. The High Cost Fund Has Become the Primary Rural Investment Cost Recovery Mechanism

The very small profit potential of sparsely populated rural markets offers little or no incentive for private entities to make the substantial investments necessary to construct, maintain and upgrade rural telecommunications networks unless they have reasonable assurance that they can recover their investment costs. Prior to the establishment of the Universal Service Fund in 1985, the Rural Electrification Administration (“REA”) loan program, the Bell System settlements system, state commission certification and carrier-of-last resort requirements, and rural telephone cooperatives were all employed in various ways to induce the construction of telephone networks in rural areas where normal economic processes and incentives had not produced significant network investment.

From the break-up of the Bell System to the implementation of the 1996 Act, access charges and the Universal Service Fund provided assurances of cost recovery sufficient to encourage most rural telephone companies to invest in and upgrade their telecommunications networks. Since 1997, the FCC’s shift of approximately \$2.0 billion

¹ The FCC noted that overhead cost adjustments could greatly increase this already massive cost difference. Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166 (Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent

per year of cost recovery² from interstate access revenues into the High Cost Fund has made federal High Cost Fund support the predominant cost recovery mechanism for most rural telephone companies. Federal high-cost support currently constitutes a substantial portion of the revenue streams of ITCI's clients, and will grow even larger if pending "bill and keep" proposals eliminate or further reduce interstate and/or intrastate access revenues. Hence, the amount and future stability of federal High Cost Fund support have become the most critical factors in the assessment of investment projects and associated cost recovery prospects by rural telephone companies and their lenders.

C. The Existing Embedded Cost Mechanism Encourages Rural Network Investment

The existing High Cost Fund mechanism based upon embedded costs has been very successful in producing the investment necessary to maintain and upgrade rural telecommunications networks. Rural carriers and their lenders know that cost recovery from the High Cost Fund will be based upon the actual dollars invested and other actual expense outlays. They do not have to worry about (and lenders do not have to increase their interest rates to adjust for): (a) uncertainties due to the potential recalculation of "costs" as something other than actual dollar investments and expense outlays in order to account for future changes in technology and equipment prices; or (b) uncertainties due to the workings of complex models that estimate a carrier's theoretical "costs" without regard to many of its particular circumstances.

Local Exchange Carriers and Interexchange Carriers), FCC 01-304, released November 8, 2001, at para.45 and n.140.

² The FCC has transferred approximately \$500.86 million in annual Long Term Support ("LTS"), \$426.72 million in annual Local Switching Support ("LSS"), \$650.00 million in annual Access Universal Service Fund support ("AUSF") and \$372.34 million in annual Interstate Common Line Support ("ICLS") from interstate access charge mechanisms into the High Cost Fund. In addition, a substantial reason for the growth in Lifeline and Link-Up support from \$155.70 million in 1995 to \$740.00 million in 2003 has been

The simplicity, stability, certainty, accuracy and sufficiency of the existing embedded cost mechanism have encouraged reasonable and prudent investment in rural telecommunications networks. ITCI clients and other rural telephone companies have an impressive record of upgrading their networks to install digital switches and softswitches, to implement Signaling System 7, to bury lines to limit storm damage and outages, to provide local or centralized equal access, to offer custom calling options, to comply with Emergency 911 ("E-911") and Communications Assistance for Law Enforcement ("CALEA") responsibilities, and to enable access to the Internet and information services. In sum, the present embedded cost mechanism has a proven record of success in encouraging the rural network investments necessary to provide quality, affordable and reasonably comparable services to the rural residents and businesses served by rural telephone companies.

Moreover, these network investments and upgrades have been implemented without significant inefficiency or gold-plating. ITCI clients and other rural telephone companies have very minimal access and leverage in the capital markets, and must detail and justify their investment and business plans to the Rural Utilities Service, CoBank, the Rural Telephone Finance Cooperative, equipment vendors and/or local banks before they can obtain the financing necessary for substantial investments. This rigorous loan application and review process ensures that most rural network investment projects are lean and efficient, or become so before they are approved and funded. Moreover, the FCC, state commissions and NECA have the right to conduct audits and to disallow investments and expenses, if any, that are not reasonably and prudently incurred.

the need to offset increases in the federal Subscriber Line Charge ("SLC") adopted by the FCC as a part of its "access reform" orders.

In sum, the record of rural telephone companies in modernizing and upgrading their networks demonstrates the ability of the existing embedded cost mechanism to encourage investment in rural telecommunications networks. By allowing carriers in high-cost rural areas with limited profit potential to recover their actual investment outlays, the embedded cost mechanism reduces investment risks to levels where reasonable and prudent network investments can be justified to owners, directors and lenders. In addition, embedded costs are relatively easy to measure and verify, and remain stable and predictable over the useful lives of the new or upgraded network facilities. They are readily understood and used by carriers and their lenders, and can be readily reviewed and audited by federal and state regulators.

During recent years, there has been some slowing and postponement of investment by rural telephone companies. In addition to the influence of the business cycle and world events, this slowdown has been caused by uncertainty over the outcome of the pending FCC rulemakings affecting the future of the High Cost Fund, as well as by uncertainty over the future of interstate and intrastate access revenues. Moreover, the cap on high cost support is cutting increasingly into the support otherwise receivable by rural telephone companies, and is preventing them from recovering the entire cost of their investments during their originally projected useful lives.

Substantial investment in rural telecommunications networks will remain necessary during the foreseeable future. Even if Voice over Internet Protocol (“VoIP”) calls replace a substantial portion of traditional circuit-switched voice traffic, rural telecommunications networks will remain necessary to originate and/or terminate the VoIP calls of most rural residents and businesses. Current VoIP providers have not

invested in their own rural networks, and there is no indication that they plan to do so within the foreseeable future. Rather, rural telephone company networks will continue to originate, terminate and transport VoIP calls as well as other voice and data traffic.

The Joint Board and FCC can reinvigorate rural network investment by eliminating as much as possible of the current regulatory uncertainty by making a clear long-term commitment to a specific, predictable and sufficient High Cost Fund. For rural telephone companies, this means a commitment to the existing embedded cost mechanism, and the rejection of FLEC mechanisms.

D. FLEC Mechanisms Discourage Rural Network Investment

FLEC methodologies may or may not be useful in some other contexts, but they are certain to discourage investment by rural telephone companies and other small carriers if they are used to determine the availability or amount of their high-cost support.

FLEC mechanisms do not contain any inherent incentive to promote investment in high-cost areas. Rather, high-cost calculated pursuant to a FLEC mechanism will not change regardless of how much or how little a carrier actually invests in network upgrades.

Moreover, most FLEC mechanisms actually discourage investment because they focus upon the costs that carriers will incur in the future to construct and maintain theoretical efficient networks, and preclude carriers from recovering their actual investment dollar outlays if equipment prices decrease or if technological changes produce less expensive alternatives. For example, if a rural carrier invested \$1.5 million in new network facilities with an expected useful life of 10 years and the market price of the same equipment decreased to \$1.2 million during the next three years, it does not

appear that a FLEC mechanism would allow the carrier to recover its full \$1.5 million investment outlay. Likewise, if the rural carrier invested \$2.0 million in new network facilities with an expected useful life of 10 years and a technological advance four years later allowed the same functions to be performed by new equipment costing \$1.4 million, it does not appear that a FLEC mechanism would allow the carrier to recover its full \$2.0 million investment outlay.

If a small rural carrier and its lenders do not have reasonable expectations and assurances that investment outlays will be recovered, they will not make the investments. Hence, if the Joint Board and FCC replace the current specific and predictable embedded cost mechanism with a FLEC mechanism that reduces investment cost recovery in the event of future equipment price decreases and technical advances, rural carriers and their lenders will constantly be waiting for equipment prices to level off and technological changes to slow before making significant network investments. In other words, most significant network investment by rural telephone companies and other small carriers will slow to a crawl or cease entirely if a FLEC mechanism reduces or renders uncertain the recovery of their costs via the High Cost Fund.

A FLEC mechanism is also much more complex and difficult to administer than the existing embedded cost mechanism. Whereas initial embedded costs can be readily determined and verified from invoices, contracts and similar transactional documents, the estimation of forward-looking economic costs requires significant additional assumptions, predictions and modeling. Whereas systems for making depreciation calculations, overhead allocations, and other accounting determinations for rural carriers are presently in place, the development and verification of a FLEC model that can

accurately determine high-cost areas and/or calculate sufficient high-cost support for over 1,000 rural telephone companies with differing histories, network designs, demographics, geographies, topographies, climates and other potentially relevant factors is a daunting task that may never be accomplished in a satisfactory manner. A threshold question is whether the benefits of such a model will ever be worth the time, effort and cost of developing it.

The likely outcome of the substitution of a FLEC mechanism is: (a) that some rural carriers will be “winners” that recover more than actual investment costs; (b) that many rural carriers will be “losers” that are unable to recover their actual investment costs; and (c) that the specific identities of the “winners” and “losers” will change unpredictably from time to time as the FCC adjusts the FLEC model to correct discrepancies and aberrations and/or to reflect changed economic or technological conditions. The ultimate result will be uncertainty, insufficient cost recovery and other substantial disincentives for rural network investment.

ITCI does not understand why the Joint Board or the FCC would replace an embedded cost mechanism having a proven record of encouraging rural network investment with a complex and uncertain FLEC mechanism that will deter rural carriers and their lenders from undertaking many network investment projects. It urges the Joint Board and the FCC to retain the tried and true embedded cost mechanism.

IV

“Rural Carriers” Should Not Be Redefined For Universal Service Purposes

ITCI’s clients serve less than 21,000 lines, and therefore would not be adversely affected by re-definition of the terms “rural telephone company” and/or “rural carrier” to

reduce or eliminate the high-cost support provided to larger and/or medium-sized rural carriers. Nonetheless, ITCI recommends that the Joint Board and FCC retain the current statutory definition of “rural telephone company” in 47 U.S.C. Sec. 153(37) to determine which carriers are “rural carriers” for High Cost Fund purposes. This will encourage rural telecommunications network investment within the confines of the present size and scope of the High Cost Fund.

The differences in rural network investment between the non-rural carriers receiving high-cost support via the existing FLEC-based proxy model for large carriers and the rural carriers receiving high-cost support via the existing embedded cost mechanism demonstrates the superiority of the embedded cost mechanism as a provider of investment incentives. As noted above, rural carriers have upgraded their networks to install digital switches and softswitches, to implement SS7 signaling, to bury lines to limit storm damage and outages, to provide local or centralized equal access, to offer custom calling options, to comply with E-911 and CALEA responsibilities, and to enable access to the Internet and information services. In contrast, many non-rural carriers have lagged behind their smaller rural carrier counterparts in the upgrade and modernization of their rural exchanges. Even though they are large corporations, these non-rural carriers do not have unlimited resources and must answer to their stockholders and the capital markets for the profitability of their investment decisions. Because the FLEC mechanism imposed upon non-rural carriers does not provide sufficient recovery of the costs of their investments in their rural exchanges, many non-rural carriers have exercised their fiduciary duties to their stockholders and bondholders by foregoing risky and relatively unprofitable investments in their rural exchanges and by focusing instead upon more

attractive investments in urban areas and abroad. In fact, many non-rural carriers have sold many of their less profitable rural exchanges because they had no incentive or justification to invest further in them.

ITCI does not request or expect the Joint Board or the FCC to address at this time the lack of High Cost Fund incentives for non-rural carriers to invest in their rural exchanges, for this could require a major increase in the size of the High Cost Fund. However, the Joint Board and the FCC should not subject the rural networks and customers of larger and medium-sized rural carriers to similar investment disincentives by redefining “rural carrier” to reduce or eliminate their investment cost recovery from the High Cost Fund. Rather, the dominant, pro-investment objective of the 1996 Act requires that the High Cost Fund continue to encourage investment in as many rural networks as practicable. The rural residents and businesses served by these networks need high quality and reasonably comparable telecommunications services at affordable and reasonably comparable rates whether their particular networks are operated by larger, medium-sized or smaller rural carriers.

V

High Cost Support Should Be Determined and Calculated on a Network Basis

High-cost support should be calculated and distributed to all eligible telecommunications carriers (“ETCs”) on the same basis that telecommunications facilities are constructed and that telecommunications services are provided – namely, as networks. Carriers do not invest in and construct lines or wire centers; rather, they invest in and build networks. Customers do not purchase service on lines or wire centers; they

subscribe to service on a network so that they can communicate with all the other people connected to or through the network.

Networks can be readily defined and determined by the customers, communities and areas served by a switch or a commonly-owned hierarchy of switches. For example, a rural telephone company that serves four exchanges by means of a host switch and three remote switches is operating a network comprised of the service areas of the four switches. Likewise, a wireless carrier that serves the I-90, I-94, I-39 and I-43 corridors of Wisconsin via a switch in Milwaukee or Madison and cell sites in Milwaukee, Madison, Sheboygan, Green Bay, Eau Claire, and La Crosse and along the highways connecting them is operating a network comprised of the switch and the urban, suburban and rural areas served by the cell sites. Likewise, a wireless carrier that serves the I-90, I-94 and I-35 corridors of Minnesota via a switch in Minneapolis and cell sites in Minneapolis, St. Paul, St. Cloud, Morehead and Duluth and along the highways connecting them is operating a network comprised of the switch and the urban, suburban and rural areas served by the cell sites.

Networks provide a clear and readily ascertainable and verifiable basis for assigning and allocating investments, operating expenses and overhead. In contrast, many of the problems and distortions of the current "portable" high-cost support mechanism are due to a lack of focus upon the essential network character of telecommunications investment and service. Calculation and distribution of high-cost support to ETCs on a "per line" basis has distorted network investment and support outlays because both ILECs and CETCs build and operate their facilities as networks rather than as lines. Allocation of fixed network investment costs to lines means that the

a portion of the cost of the carrier's investment in its network may not be recovered if the line to which it is allocated is "lost" to another carrier or removed from service, even though all network facilities remain in place.

Similarly, calculation and distribution of high-cost support on a wire center basis requires artificial assignments and allocations of investment costs and other expenses below the network level at which they were made. These assignments and allocations are not based upon actual network investment and operating activities, and can produce distortions or gamesmanship in the determination and reporting of costs.

Experience generally shows that simple and straightforward mechanisms work most efficiently, effectively and equitably. Given that carriers invest and provide service on a network basis, the high-cost support necessary to recover the costs of these investments should be determined and calculated on the same network basis. This congruence will enable investments and cost recovery to be monitored on a readily ascertainable basis, and will encourage the making of reasonable and prudent network investments.

VI

CETCs Should Receive High Cost Support On The Basis Of Their Own Embedded Costs

Competitive eligible telecommunications carriers ("CETCs") will receive appropriate investment signals and incentives only if they receive high-cost support on the basis of their own embedded costs of investing in their own networks.

If a CETC receives "portable" high-cost support based upon the substantially higher embedded costs of an ILEC, it will have an artificial incentive to enter the market to take advantage of the high-cost support windfall. If a CETC receives "portable" high-

cost support based upon the substantially lower embedded costs of an ILEC, it will have little incentive to enter the market or to invest further in its network because it may not be able to recover its own actual investment outlays. The most economically reasonable and competitively neutral approach is to provide high-cost support to each ETC on the basis of the embedded costs of its own network.

Network-based support is a crucial consideration. For example, if the hypothetical wireless carriers described in the previous section that serve the interstate highway corridors of Wisconsin and Minnesota are designated as CETCs, they should receive high-cost support on the basis of their averaged embedded costs throughout their entire networks, and not on the basis of their costs within a particular cell site or on the basis of the costs of individual rural ILECs whose service areas they overlaps along a portion of one of the highways. In other words, large wireless carrier networks serving states or large regions should receive high-cost support on the same basis as the regional networks of comparable ILECs.

CETCs requesting high-cost support should be required to adopt and implement the same accounting and cost reporting practices as ILECs and other recipients. If a carrier expects to receive tens or hundreds of thousands of dollars of federal high-cost support to help it to recover its actual costs of investing in a rural network, it is reasonable and competitively equitable that it be required to maintain the accounts and records necessary to calculate and verify the costs that determine the amount of its support.

VII

Conclusion

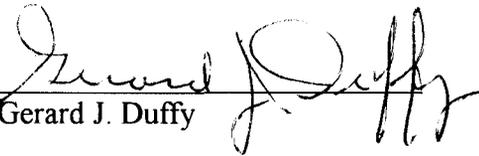
The Joint Board and FCC should evaluate all potential high-cost support mechanisms on the basis of their ability to encourage investment in rural telecommunications networks. This is the approach that best complies with the dominant pro-investment goal of the 1996 Act and its universal service provision.

If the Joint Board and FCC focus upon incentives for investment, they will retain embedded costs as the most effective federal high-cost support mechanism that can be employed for rural carriers during the foreseeable future. ITCI submits that the existing embedded cost mechanism has furnished the assurances of cost recovery necessary to produce reasonable and prudent investment by rural telephone companies in their rural networks during the past two decades. The proven record of success of the embedded cost mechanism as an incentive for rural network investment mandates its retention for all rural telephone companies as well as its use for CETCs.

Moreover, there is no need or valid reason for the Joint Board or FCC to re-define “rural telephone company” or “rural carrier” to remove larger or medium-sized rural telephone companies from the embedded cost mechanism, or to limit or reduce their high-cost support. The existing embedded cost mechanism has been much more successful than the FLEC mechanism imposed upon non-rural carriers in encouraging the upgrade and modernization of rural telephone exchanges. Customers of larger and medium-sized rural telephone companies should not be deprived of the upgrades necessary to provide them with high quality, affordable and reasonably comparable services.

Finally, CETCs should be furnished high-cost support on the basis of their own embedded costs throughout the actual networks that they serve. If they wish to receive substantial amounts of high-cost support, they should be required to implement the accounting standards and cost reporting procedures necessary to determine and verify their costs and related support.

Respectfully submitted,
INTERSTATE TELCOM CONSULTING, INC.

By 
Gerard J. Duffy

Its Attorney

Blooston, Mordkofsky, Dickens, Duffy & Prendergast
2120 L Street, NW (Suite 300)
Washington, DC 20037
Telephone: (202) 659-0830
Facsimile: (202) 828-5568
E-mail: gjd@bloostonlaw.com

Dated: October 15, 2004

Interstate Telcom Consulting, Inc. List of Participating Companies

24-7 TELCOM, INC.	LORETEL SYSTEMS, INC.
ACE LINK TELECOMMUNICATIONS, INC.	LOST NATION-ELWOOD TELEPHONE COMPANY
ACE TELEPHONE ASSOCIATION	LUCK TELEPHONE COMPANY
ACE TELEPHONE COMPANY OF MICHIGAN	MABEL COOPERATIVE TELEPHONE COMPANY
AMERY TELCOM INC.	MADELIA TELEPHONE COMPANY
AMHERST TELEPHONE COMPANY	MANAWA TELEPHONE CO., INC.
ARROWHEAD COMMUNICATIONS CORP.	MARQUETTE-ADAMS TELEPHONE COOPERATIVE, INC.
BAYLAND COMMUNICATIONS, INC. (CLEC)	MIDWEST TELEPHONE COMPANY
BAYLAND TELEPHONE, INC.	MILLTOWN MUTUAL TELEPHONE COMPANY
BERGEN TELEPHONE COMPANY	MINBURN TELECOMMUNICATIONS, INC.
BERNARD TELEPHONE COMPANY	MINBURN TELEPHONE COMPANY
BLOOMER TELEPHONE COMPANY	MINNESOTA VALLEY TELEPHONE CO., INC.
BRUCE TELEPHONE CO., INC.	NELSON TELEPHONE COOPERATIVE
CHEQTEL COMMUNICATIONS, INC.	NIAGARA TELEPHONE COMPANY
CHEQUAMEGON COMMUNICATIONS COOP., INC.	OSAKIS TELEPHONE COMPANY
CHIBARDUN TELEPHONE COOPERATIVE, INC.	PEOPLES TELEPHONE COMPANY, INC.
CITIZENS TELEPHONE COOPERATIVE, INC.	PINE ISLAND TELEPHONE COMPANY
CLEAR LAKE TELEPHONE COMPANY, INC.	PRICE COUNTY TELEPHONE COMPANY
COCHRANE COOPERATIVE TELEPHONE CO.	RED RIVER RURAL TELEPHONE ASS'N.
COON VALLEY FARMERS TELEPHONE CO., INC.	RICHLAND-GRANT TELEPHONE COOP., INC.
CTC TELCOM, INC.	SHARON TELEPHONE COMPANY
DELAVAN TELEPHONE COMPANY	SIREN TELEPHONE CO., INC.
EAGLE VALLEY TELEPHONE COMPANY	SLEEPY EYE TELEPHONE CO.
FARMERS INDEPENDENT TELEPHONE COMPANY	SOMERSET TELEPHONE CO., INC.
FARMERS MUTUAL TELEPHONE CO. (OHIO)	SPRING GROVE COOPERATIVE TELEPHONE CO.
FELTON TELEPHONE CO., INC.	SPRING VALLEY TELEPHONE CO., INC.
GRANADA TELEPHONE COMPANY	STATE LONG DISTANCE TELEPHONE CO.
HAGER TELECOM, INC.	THE MOSINEE TELEPHONE COMPANY
HARMONY TELEPHONE COMPANY	3 RIVERS TELEPHONE COOP.
HILLSBORO TELEPHONE COMPANY, INC.	TRI-COUNTY TELEPHONE COOPERATIVE, INC.
HOME TELEPHONE COMPANY	UNION TELEPHONE COMPANY
INDIANHEAD TELEPHONE COMPANY	VERNON TELEPHONE COOPERATIVE, INC.
LAKEFIELD COMMUNICATIONS, INC.	WEST WISCONSIN TELCOM COOPERATIVE, INC.
LAKEFIELD TELEPHONE COMPANY	WINTHROP TELEPHONE COMPANY
LAVALLE TELEPHONE COOPERATIVE, INC.	WITTENBERG TELEPHONE COMPANY