Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109
	)	
Universal Service Reform – Mobility Fund	)	WT Docket No. 10-208

COMMENTS
of
MIDVALE TELEPHONE EXCHANGE, INC.

TABLE OF CONTENTS

INTRODUCTION AND SUMMARY iii

I. ANALYSIS PERFORMED BY MTE **1**

II. THE MODEL DOES NOT YIELD CONSISTENT RESULTS FOR SIMILARLY SITUATED COMPANIES **2**

III. THE FCC'S REGRESSION ANALYSIS DOES NOT CONSIDER THE IMPACTS OF DEPRECIATION RESERVE **6**

IV. THE LIMITATIONS ARE APPLIED INCORRECTLY TO THE HIGH COST LOOP SUPPORT ALGORITHM **6**

V. THE LIMITATIONS ARE MISSING CRITICAL COMPONENTS **7**

VI. THE FCC'S REGRESSION ANALYSIS DOES NOT APPROPRIATELY CALCULATE LIMITATIONS ON DEPRECIATION EXPENSE **8**

VII. CONCLUSIONS **9**

Introduction and Summary

The Federal Communications Commission's (Commission or FCC) *Report and Order and FNPRM*[1] in the above captioned proceeding requests comment on proposed changes to the existing Universal Service Fund (USF) and Intercarrier Compensation (ICC) mechanisms for rural rate-of-return carriers, among other issues. Specifically, the FCC requests comments on Sections XVII.A-K of the *FNPRM*, which address a wide variety of USF related issues.

Midvale Telephone Exchange, Inc.[2] (MTE) submits these comments for the FCC's consideration. MTE is a rural telecommunications provider serving approximately 2,000 voice access lines and 850 broadband customers in the States of Idaho and Arizona. The following characteristics are true of MTE:

- MTE is the Carrier of Last Resort designated by the Idaho Public Utilities Commission and Arizona Corporation Commission, which legally obligates the company to provide telecommunications service to all requesting customers within its service territory.

[1] *In the Matter of Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-161 (rel. November 18, 2011) (*Report and Order and FNPRM*).

[2] MTE serves several rural, remote areas of Central Idaho and Eastern Arizona. Established in 1909, MTE's core business strategy is to seek-out and serve previously un-served areas. Because of this strategy, MTE's individual service areas are separated by several hundred miles within each State. These areas are comprised of rocky, mountainous terrain in Idaho, and rock-filled high and low desert, as-well-as mountainous terrain in Arizona. In most cases, MTE's serving areas are over 100 miles from significant population centers. Local economies in these areas are primarily reliant on agriculture, mining, tourism, and home-based business.

- MTE is the Eligible Telecommunications Carrier (ETC) determined by the Idaho Public Utilities Commission and Arizona Corporation Commission to provide universal service within the company's designated service territory.

- MTE receives High Cost Support from the Federal Universal Service Fund. This support totaled $4,759,140 in 2010[3] and comprised over 55% of MTE revenues in 2010. Support came from the following sources:

    - High Cost Loop Support (HCLS) $2,305,828
    - Interstate Common Line Support (ICLS) $1,559,028
    - Local Switching Support (LSS) $ 894,284

- MTE generates substantial revenues from providing intrastate switched access and reciprocal compensation services. In 2010 intrastate switched access and net reciprocal compensation revenues totaled $334,306.

- MTE provides voice and broadband services to schools, libraries, rural health care facilities, governmental agencies, and/or other anchor institutions within its service territory.

- MTE is one of the, if not the, largest employers in the company's rural service territory, providing jobs and financial stability in rural areas of Midvale, Stanley, Lake View and Warren, Idaho, also, Cascabel, Prescott Valley, and Young, Arizona. In 2010, MTE employed 52 people and provided combined payroll and benefits of $3,495,000.

[3] 2010 revenues are used throughout these comments because final 2011 numbers are not yet known. We believe that 2010 revenues are reasonably representative of 2011.

- MTE has deployed substantial financial and human resources to provide voice and broadband services under the existing rate of return rules prescribed by the FCC and by the Idaho Public Utilities Commission and the Arizona Corporation Commission. In 2010, MTE had gross regulated investment of $34,598,582

- MTE would not have had the financial resources to deploy and maintain either voice or broadband services without rate of return regulation and the support of the Universal Service Fund under the existing rules.

- MTE is very concerned with the potential financial implications of the *Report and Order and FNPRM* and the impact they will have on MTE' ability to continue to provide high quality voice and broadband services at the public interest standards established by the Commission.

In these comments, MTE outlines the impacts that adoption of the limitations on capital and operating expenses, as proposed in the *Report and Order and FNPRM*, would have on its financial results.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
	)	WC Docket No. 07-135
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	
	)	
	)	WC Docket No. 05-337
High-Cost Universal Service Support	)	
	)	CC Docket No. 01-92
Developing an Unified Intercarrier Compensation Regime	)	
	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on Universal Service	)	
	)	WC Docket No. 03-109
	)	
Lifeline and Link-Up	)	WT Docket No. 10-208
Universal Service Reform – Mobility Fund		

COMMENTS
of
MIDVALE TELEPHONE EXCHANGE, INC.

I. Analysis Performed by MTE[4]

In order to provide relevant financial context to the FCC in these comments, MTE engaged Moss Adams LLP[5] to perform a detailed financial analysis of the potential impacts of

[4] Midvale Telephone Exchange was incorporated in Idaho in 1959. The company (MTE) has ILEC operations in Idaho and Arizona. For the purposes of the comments, MTE will focus on the impacts of the proposed regression analysis on the Arizona study area, SAC #452226 (MTE – AZ).

[5] Moss Adams LLP (Moss Adams) is the 11th largest accounting and consulting firm in the United States, with more than 225 partners and 1,800 staff. Moss Adams' Telecom Group has served the telecommunications industry since 1957. Today, they provide audit, tax, and consulting services to more than 80 small and mid-sized telecommunications carriers throughout the United States and its territories.

the limitations on capital and operating expenses proposed in the *Report and Order and FNPRM*. This analysis primarily focused on the impacts of the proposed regression analysis identified in Appendix H to the *Report and Order and FNPRM*. This analysis was performed using MTE data used by, and provided by, the FCC in the development of its regression analysis. In doing so, Moss Adams recreated the regression analysis performed by the FCC and reproduced the same results. In addition, Moss Adams also utilized other information generally available from MTE in the analysis. The following comments include our overall assessment of the FCC's regression analysis and provide a summary overview of the financial impacts on MTE, including the impacts of changes in the analysis proposed by MTE.

II. The Model Does Not Yield Consistent Results for Similarly Situated Companies

In defining similarly situated companies, the FCC must consider factors that drive the true cost of loop facilities. MTE notes that the FCC's model used to perform the regression analysis did not take some of the primary drivers of loop costs into account, such as the length of loops – a major factor leading to high loop costs. The model also does not take into account the poor soil conditions and rocky terrain that MTE - AZ must contend with, which often requires rock be cut or bored to bury cable plant. These conditions often cause significant delays and cost increases to place cable plant. These items are important as higher costs of construction and significant distances between subscribers justify higher level of investments, expenses and the amount of inventory on hand. Specifically related to materials inventory, MTE points out that when comparing it to similarly situated companies like those listed in the table below, companies with higher concentrations of loops/subscribers had significantly higher cable and wire and

central office plant inventory caps than MTE which runs contrary to what logically should be the case.

MTE - AZ's service area has 0.99 loops per square mile. The Commission's proposed regression model would place a ceiling or cap on MTE - AZ's materials inventory assigned to AL7 - cable and wire loop facilities and AL8 - central office equipment. The table provided below compares loops, land area served and the resulting caps under the proposed regression model. The table supports MTE's position that areas with few subscribers, or loops, per mile necessitate higher values under the regression caps and that caps should be comparable for similarly situated companies. Of the six companies listed on the table, four have more loops per mile, (*i.e.*, have a higher population density than MTE - AZ), however all four have significantly higher caps per mile than MTE - AZ. Specifically, Example E Telephone with 5.34 loops per mile, serves nearly the same number of loops as MTE - AZ (1,159 for Example E versus 1,240 for MTE), but pursuant to the Commission's regression model, has a significantly higher cap in areas where they are limited for MTE - AZ. The regression model yields a cap of $295 per mile on AL7 for Example E Telephone. This is significantly higher than the $93.51 for MTE -.AZ MTE points out that utilizing the Example E per mile numbers for its area would yield an AL7 cap of $370,166, significantly higher than MTE - AZ's current cap and much more consistent with its actual investment. MTE also points out that Example B which has a density very consistent with MTE - AZ's density (.89 loops per mile for Example B), has a cap that is also lower than four of the companies depicted in the table provided with more loops per mile. This is yet another example of the regression analysis not producing consistent results for similarly situated companies.

MTE invested over $4,000,000 in new infrastructure in Arizona in 2010. Nearly all of this construction was done internally. Obviously, with construction comes the need for inventory. MTE often buys materials well in advance of actual construction in order to obtain materials at the best discount, or insure availability. This process can inflate inventory for a short period of time, but inventory levels will drop as construction progresses.

	Loops	Land Area	AL7 - FCC Cap (Est.)	Cap/Mile	Loops/Mile
Example A	957	19	19,511	1,053.04	51.65
MTE	1,240	1,255	117,335	93.51	0.99
Example B	1,206	1,357	151,953	111.95	0.89
Example C	1,026	82	31,301	382.59	12.54
Example D	1,277	177	191,983	1,087.11	7.23
Example E	1,159	217	64,025	295.00	5.34
Example E Cap/Mile for MTE =			370,166.41		

The Commission's proposed regression model would also place a ceiling or cap on MTE - AZ's maintenance expense assigned to AL13 - CWF Maintenance assigned to Cat. 1.0 and AL14 - COE maintenance assigned to Cat. 4.13. The table provided below compares loops, land area served and the resulting caps under the proposed regression model for the same peer group as were compared in the table above. Of the six companies listed on the table, four have more loops per mile, (*i.e.*, have a higher population density than MTE - AZ), however all four have significantly higher caps per mile than MTE - AZ. Specifically, Example E Telephone with 5.34 loops per mile, serves nearly the same number of loops as MTE - AZ (1,159 for Example E versus 1,240 for MTE - AZ), but pursuant to the Commission's regression model, has a significantly higher cap in areas where they are limited for MTE - AZ. The regression model yields a cap of $1,824 per mile on AL14 for Example E Telephone. These are significantly higher than the $147 for MTE – AZ. MTE points out that utilizing the Example E per mile numbers for its area would yield an AL14 cap of $2,289,798, significantly higher than MTE -

AZ's current cap. MTE again points out that Example B which has a density very consistent with MTE - AZ's density (.89 loops per mile for Example B), has a cap that is also lower than four of the companies depicted in the table provided with more loops per mile. This is yet another example of the regression analysis not producing consistent results for similarly situated companies.

MTE's service areas in both Idaho and Arizona are separated by hundreds of miles. Travel time between areas can take longer than 10 hours. This obstacle necessitates the hiring and positioning of service technicians at each area, in order to provide support and response times with the requirements of the Arizona Corporation Commission and the Idaho Public Utilities Commission. This unique situation requires more employees than a more traditional ILEC. It dramatically increases MTE's employee count per subscriber and cost per subscriber.

	Loops	Land Area	AL14 - FCC Cap (Est.)	Cap/Mile	Loops/Mile
Example A	957	19	157,407	8,495.40	51.65
MTE	1,240	1,255	184,976	147.42	0.99
Example B	1,206	1,357	210,693	155.22	0.89
Example C	1,026	82	248,206	3,033.84	12.54
Example D	1,277	177	257,568	1,458.48	7.23
Example E	1,159	217	396,052	1,824.84	5.34

Example E Cap/Mile for MTE = 2,289,798.05

There are several ways to improve the FCC's regression model. MTE and other carriers can provide the FCC with average loop lengths and other relevant data similar to what many carriers do for the United States Department of Agriculture Rural Development Utilities Program Form 479. Because loop lengths and density are a major component of loop costs, expense and inventory levels, it is critical they be included in order for the model to work accurately. Terrain

data is also not included in the model, other than percentage of water in the study area, which is not a significant driver of loop costs.

III. The FCC's Regression Analysis Does Not Consider the Impacts of Depreciation Reserve

The FCC's model used to perform the regression analysis does not take the depreciation reserve of the plant being limited into account; it is purely analyzed on a gross plant value. Companies like MTE deploy their network over time and, as a result, must regularly replace facilities as they are reaching the end of their useful life. In addition, they will continue to make the necessary network changes, which will require additional investment, to meet the Commission's 4 Mbps downstream/1 Mbps upstream broadband requirements. The regression model as proposed does not allow for this, and its failure to recognize the impacts of depreciation reserve is a significant flaw in the model.

IV. The Limitations Are Applied Incorrectly to the High Cost Loop Support Algorithm

MTE believes there are three accounting issues that must be addressed in the calculation and application of the proposed regression-based limitations. First, the High Cost Loop Support ("HCLS") data inputs ("data lines" or "DL") should be limited, not the outputs ("algorithm lines" or "AL"). Second, the limitations must take into account the impact of accumulated depreciation and other Part 32 accounts on the calculation of support. Third, the methodology used to calculate the limitations on depreciation expense must be modified.

MTE believes that the limitations should be applied to the HCLS data lines instead of the algorithm lines, which would allow the 26 step algorithm to work as designed. The current

limitation of the algorithm lines does not account for the interrelationship between many of the data lines used in the calculation of support. It should be noted that all of the algorithm lines are calculations based on various data lines, so any proposed limitations can also be accomplished by adjusting the data lines. As currently proposed, the FCC's regression model limits outputs, rather than limiting inputs and allowing the inputs to be run through the model. An excellent example of this is AL 3, also referred to as the "A" Factor, which is calculated as Cable and Wire Facilities (CWF) divided by Total CWF. The "A" Factor is used in the allocation of expenses associated with CWF. AL 3 is one of several algorithm steps that uses both AL and DL inputs to produce the result; in this case AL1, DL 255 (Account 2400 - Total CWF) and DL 815 (Account 2680 – Amortizable Tangible Assets – CWF). The FCC's proposed treatment only limits the AL1 amount, however, neither DL 255 (which includes AL1) nor DL 815 are adjusted. As a result, the algorithm is not allowed to calculate support as it was intended and produces an incorrect result.

V. The Limitations Are Missing Critical Components

As mentioned above, accumulated depreciation and other Part 32 accounts must be taken into consideration if the FCC is going to limit the 11 proposed algorithm lines, or follow the approach to limiting the data lines described above. The FCC's proposed regression analysis does not limit the accumulated depreciation, nor does it remove amounts from other associated accounts. If the FCC is going to limit investments, the following data lines should also be analyzed:

DL 160 – Account 2001 – Total Plant in Service

DL 190 – Account 3100 – Accumulated Depreciation

DL 240 – Account 2230 – COE Transmission Equipment

DL 250 – Account 2230 – COE Category 4.13

DL 255 – Account 2410 – Total CWF

DL 270 – Account 3123 – COE Transmission Accumulated Depreciation

DL 280 – Account 3124 – CWF Accumulated Depreciation

DL 700 – Cost Study Average CWF – Total Account 2410

DL 710 – Cost Study Average CWF Cat 1 – Total Subscriber Line Plant

By not analyzing these data lines, the FCC's regression analysis yields flawed and punitive results. In addition, as discussed above, limiting the algorithm lines and not the data lines does not allow the HCLS algorithm to work as designed. There could be some question as to how to appropriately limit the accumulated depreciation reported on DL 190, DL 270, and DL 280, but this could be handled one of two ways. First, a ratio of limited investment in the associated plant account to the total plant account could be developed and applied to the accumulated depreciation. Alternatively, the limited plant could be handled as a retirement, in which case Part 32 for retirement accounting would treat the investment as fully depreciated. Whichever method is selected would be more appropriate than the current approach of ignoring depreciation reserve and other associated accounts in the algorithm. The limitation of algorithm lines rather than data lines yields inappropriate results and ignores the net book value of the assets being removed.

VI. The FCC's Regression Analysis Does Not Appropriately Calculate Limitations on Depreciation Expense

Depreciation expenses have not been properly accounted for in the FCC's regression model. Specifically, depreciation expenses should not be analyzed independently via regression,

as they are a byproduct of the associated plant investment. Instead, depreciation expenses should be reflected as a function of the asset values removed. The FCC's current, regression-based approach results in limitations on depreciation expenses on AL 17 and AL 18 that are excessive and inconsistent with Part 32 accounting principles. The FCC's current approach also creates situations like MTE - AZ where the depreciation expense is limited when the associated plant account is not limited. The regression Model established AL 17, Cable and Wire Facilities (C&WF) Amortization and Depreciation as a dependent Variable. In MTE - AZ's case, the Regression Model AL1 C&WF is not capped, indicating MTE - AZ's current plant investment is below the threshold. However, MTE - AZ's AL 17, C&WF Amortization and Depreciation is capped.

This would suggest that the depreciation rates for these accounts are excessive, which is nearly impossible in a regulated environment. MTE - AZ's depreciation rates are approved by the Arizona Corporate Commission and are therefore not subject to unilateral adjustment by the company. Finally, MTE is audited annually by an independent CPA firm that verifies the proper use of the approved depreciation rates, thus there is minimal risk of improper application. Therefore, we recommend that regression not be used to limit depreciation expense. Instead, we believe that depreciation expense limitations should be computed as the percentage of limitation of the associated plant investment multiplied by depreciation expense.

VII. Conclusions

Should the proposed actions contained in the *Report and Order and FNPRM*, and referred to in these comments be enacted, the negative impact on MTE would be immediate and devastating. MTE's first response would likely be to reduce its workforce by 15% to 20%. In

addition to the personal and financial turmoil of the terminated employees, this would adversely affect MTE's traditional high level of customer service and degrade its ability to respond to its customers' needs in a timely fashion. MTE's customers would also suffer from its inability to invest in network upgrades and expansion. Historically, MTE has placed its highest emphasis on providing the best possible service to its customers by continually upgrading and expanding its network. If the changes in the *Report and Order and FNPRM* are approved as proposed, MTE's plans to continue expansion of broadband availability, increase broadband speeds, and provide access to the most current technology will be rendered financially impossible.

Finally, because of MTE's strategy of serving previously un-served areas, its individual serving areas are not contiguous. Rather, they are separated by several hundred miles within each State. Furthermore, MTE's serving areas have an extremely low population density, resulting in loop-lengths far longer than the industry average. Also, the rocky, mountainous terrain of Idaho, and the rock-filled, decomposed granite soil in Arizona makes construction incredibly difficult and expensive. None of these cost-affecting factors are considered in the *Report and Order and FNPRM*.

MTE has been provident in the use of the support money it has received through the current support mechanism. With that money, MTE has been able to upgrade, expand, and offer more services to its customers. MTE currently offers broadband speeds of 4Mb+ to over 98% of its customers, and broadband speeds of 10Mb+ to over 90% of its customers. Throughout its history, MTE has been proactive by investing in infrastructure and serving, almost exclusively, previously un-served areas. By serving previously un-served areas, and by continually investing in infrastructure to meet its customers' demand for ever increasing broadband speeds, MTE has, in fact, been doing exactly what the service provisions of the *Report and Order and FNPRM*

mandate. MTE argues that the caps proposed in the *Report and Order and FNPRM* would be inconsistent with that mandate, and effectively penalize MTE for historically doing exactly what the over-arching goals of the *Report and Order and FNPRM* seek to achieve.

January 18, 2012

Respectfully Submitted

/s/ Steve Child

MIDVALE TELPHONE EXCHAGE
By:
Steve Child, CEO
2205 Keithley Creek Road
Midvale, ID 83645
208.355.2211