Senate Energy & Telecomm.Comm.
Exhibit No. 2
Date 4.12.05
Bill No. INFO

MONTANA
TELECOMMUNICATIONS
ASSOCIATION

Senate Energy and Telecommunications Committee
April 12, 2005

Background:

Independent telephone companies of Montana collectively:

- Provide "traditional" local exchange wireline telephone service, as well as:
  - Wireless service, Internet (dial-up and broadband DSL), satellite, long distance
- Provide service to over 31 percent of Montana's telecommunications consumers working and residing in roughly 80 percent of Montana's land mass, using over 178,000 access lines.
- Invest over $70 million annually in telecommunications infrastructure in Montana
- Employ over 1,000 Montanans with premium jobs and benefits
- Deploy high-speed DSL Internet capabilities to over 255 Montana towns and communities
- Deploy over 5,000 miles of fiber optic lines throughout the state
- Deploy over 125 videoconference facilities throughout the state, used for distance learning, telemedicine, court proceedings, etc.
- Range in size from less than 1,000 "access lines" to nearly 65,000 access lines
- Comprise shareholder/publicly-owned companies, family-owned for-profit commercial enterprises, and member/subscriber-owned non-profit cooperatives

Economics of rural telephony: The Rural Difference

The Rural Task Force, convened by the FCC in January, 2000, included representatives of AT&T, Western Wireless (CellularOne), competitive local exchange companies, and rural telephone companies (including Joan Mandeville, Blackfoot Telephone Cooperative), as well as consumer representatives and state and federal regulators. The Task Force produced a series of White Papers that can be found at www.wutc.wa.gov/rtf.

In White Paper 2, "The Rural Difference," the Task Force detailed the characteristics of rural carriers, providing the policy justification for rural, high cost universal service support. MTA notes that Montana's rural carriers exhibit all of these "rural differences" to a far greater extent than described in the following national context.

- *Rural carriers serve more sparsely populated areas.* The average population density is only 13 people per square mile for areas served by rural carriers, compared with 105 people per square mile in areas served by non-rural carriers. [MTA's members serve on average fewer than 3 people per square mile.]
- *Rural carriers have relatively high costs because of the lack of economies of scale and density.* Rural carriers experience difficulty and high cost in moving personnel, equipment and supplies to remote communities. Geographic surface conditions

require expensive, specialized outside plant construction practices. More resources, including duplicate facilities and backup equipment are required to protect network reliability.

- *The customer base of rural carriers generally includes fewer high-volume users, depriving rural carriers of economies of scale.* Multi-line business customers and special access services contribute far less revenue to rural carriers than to non-rural carriers.
- *Customers of rural carriers tend to have a relatively small local calling scope.* Seventy to 80 percent of customers of smaller rural carriers can reach fewer than 5,000 other customers with a local call.
- *Rural carriers have substantially fewer lines per switch than non-rural carriers.*
- *Total investment in plant per customer is substantially higher for rural carriers than for non-rural carriers.*
- *Plant specific expenses for rural carriers are substantially higher* than for non-rural carriers as the subscriber base decreases.
- *Customers served by rural carriers have lower household incomes* and comprise a higher percentage of Native American customers.

The Three-Legged Stool (revenue sources for rural telcos):

With high costs and low customer density, **rates** alone are insufficient to maintain the level of investment needed to provide quality (or any) telephone service in rural areas, particularly the most sparsely populated areas such as Montana. In fact, rates provide less than 50% and as little as 20% of the revenues rural telephone companies need to maintain their investment and service. In addition to customer rates, telephone companies receive revenues from two other sources:

- **Access charges**: the "wholesale" rates that telephone networks charge to terminate and originate calls on each others' networks; and
- **Universal Service**: a federal pooling mechanism that distributes funds to companies with costs above a national benchmark cost, for the purpose of implementing federal statute that ensures access by rural consumers to telephone services at rates and a level of quality that are comparable to the rates and quality of services available to urban consumers.

Threats to Access Charges and Universal Service Support

- Steady reductions in access charges have resulted in commensurate increases in end-user rates through additional **subscriber line charges** and additional universal service contributions. Several influential parties are urging the FCC to eliminate access altogether and replace access with a "**bill and keep**" form intercarrier compensation, in which each network bills its own customers and keeps all customer revenues. "Bill & keep" fails to recognize the legitimate costs of interconnecting networks. And "bill & keep" would be devastating for rural consumers, as it would be impossible for rural networks to bill their customers enough to maintain sufficient network investment.

- Universal Service also is threatened. As the FCC reduced access charges, it shifted funds from access to end-user charges and to the universal service support mechanism. Thus, the universal service "pool," which is funded by an assessment on most (but not all) telecommunications services, has grown substantially as access charges have been reduced. And again, end users have footed the bill. Current assessments for universal service are in the range of 10% of interstate billings.
- Further, as states designate additional "**eligible telecommunications carriers**" (ETCs) to receive universal service support, even more pressure is placed on the universal service fund, raising concerns that universal service itself may become the target for reductions and other "reforms" that would result in loss of substantial revenues that are necessary for network investment in rural, high-cost areas of the country (i.e., Montana). The FCC in 2004 issued Orders (e.g., *Virginia Cellular*) imploring states to impose more rigorous scrutiny of ETC applications and to impose various public interest standards on applicants for ETC designation, including, among other things, the effect of such designations on the size of the universal service fund. On March 17, 2005, the FCC released an Order recommending states to adopt more stringent requirements for designating ETCs.

  As demand on universal service support increases, contributions are decreasing. For example, only a "safe harbor" portion of wireless traffic is subject to universal service contributions. Further, some telephone traffic, such as Internet-based telephone traffic, does not contribute to universal service (or access) at all.

FCC Proceedings

The FCC currently is reviewing proposals to reform intercarrier compensation, ranging from eliminating the access charge system and replacing it with a bill & keep regime, to maintaining—albeit in an altered state—the "three revenue streams" that currently support investment in rural telecommunications networks. MTA supports maintaining three revenue streams (rates, access, and universal service). Most of these plans, however, would add to or create a new universal service mechanism, and add to end-user bills.

The FCC also has opened proceedings related to universal service. One proceeding is exploring how state commissions should designate additional eligible telecommunications carriers (ETCs). As in the FCC's *Virginia Cellular* ETC decision, the Federal-State Joint Board on Universal Service recommended much more rigorous scrutiny of applications for designation of ETCs, proposing several conditions regarding build-out plans, service quality, and other commitments that applicants for competitive ETCs should meet before designation. In addition to the Joint Board's recommendations, it is essential that the FCC require individual ETCs to base the level of universal service support they receive on their own costs. Current FCC policy allows a competitive ETC (CETC) to receive the same level of universal service support as an incumbent ETC, regardless of the applicant's actual costs. Thus, if the applicant (CETC) costs are less (because the CETC can combine owned, leased, or resold services), it can receive support far in excess of the actual costs associated with providing universal service. Financial analysts consider the current system of providing

CETC support based on the incumbents' costs as pure windfall for CETCs, effectively subsidizing competition, instead of ensuring access to essential quality service.

Proceedings at the PSC

- The Commission is in various stages of consideration of several applications for ETC designation
  - D2003.1.14. Western Wireless (WWC), d.b.a. CellularOne. Application for ETC designation in certain Qwest exchange areas. The Commission granted WW's application, requiring the CETC to meet certain public interest conditions. WWC objected to the conditions, but the Commission denied WWC's objections, and has certified Western Wireless as eligible to receive universal service support funds.
  - D2023.8.105. Mid-Rivers Cellular. Application for designation in Mid-Rivers Cooperative's and Range Telephone Cooperative's service areas. The Commission granted this application—the first such designation for a wireless ETC serving rural areas—with conditions similar to those imposed in the WWC docket.
  - Several other incumbent local exchange carriers in Montana have filed requests for ETC designation.
- L-04.07.5-RUL. ETC Rulemaking
  - MTA and MITS jointly filed a petition for rulemaking in February, 2004, requesting the Commission to establish public interest standards to apply to any ETC application. The Commission conducted a hearing on proposed rules on December 3, 2004. The standards are consistent with the conditions established by the FCC's *Virginia Cellular* Order, and its recent ETC Order. MTA notes that nothing in Federal statute authorizes the use of universal service support to promote competition. Competitors are free to compete. Designation of ETCs, however, involves a public interest determination before a carrier can be granted access to universal service support. With such access comes public obligations to provide carrier-of-last-resort service, quality, and commitment. Moreover, abuse of universal service for purposes of gaining corporate windfalls at public expense damages legitimate investment in high cost rural areas.
- Lifeline (Low Income Telephone Assistance
  - The Commission has scheduled a hearing for May 3 to consider rules adopting a federal order which expands lifeline assistance on Tribal lands.