A Small Company’s Perspective on:

Is this the year the FCC reforms Universal Service and Intercarrier Compensation?

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How are the proposed changes likely to impact state commissions and consumers around the nation?
Presented by:

Steven Bowers, President
Moultrie Independent Telephone Company
Lovingston, Illinois

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Is this the year the FCC reforms Universal Service and Intercarrier Compensation?

Yes, because circuit-switched voice telephony (as opposed to other telephony-based services, e.g., facsimile) is migrating to VoIP.

Telecommunications in general is migrating to broadband.

Regulatory agencies failed to recognize the significance of that migration in a timely manner. Therefore, in order to maintain control, they must reform by redefining how support mechanisms measure and apply, and whether all carriers, or just carriers of last resort, shall be entitled to full support based upon embedded technology and each technology’s redefined cost analysis methodology.
How are the proposed changes likely to impact state commissions and consumers around the nation?

Current Universal Service Funds

- Specific, purpose-directed, non-appropriated
- Not controlled by Congress or state legislatures
- Controlled by federal and state agencies
- Levels driven by measured support requirements

Universal Broadband Service Support Funds

- Funded by an excise tax on Internet
- Appropriated funds that can be earmarked
- FCC has oversight authority
- States only determine legacy services (Public Information and Safety)
Impacts of Current Political Environment

Commissions are Political Entities with many Masters

Congress
  Oversight Committees and their members

State Legislatures
  Oversight Committees and their members

Federal and State Executives
  Constituency demands

Judiciary
  Lawmaking from the bench

PACs provide financial incentives for any or all of the above
Government Requirements v. Public Demand

Control v. Privacy

- Government monitoring of communications – Homeland Security
- Dedicated circuit interception normally requires court orders, etc.
- Digital packet network is already monitored

Landline v. Wireless

- Wireless systems have migrated to packet network/transport technology
- Landline network predominantly remains a dedicated circuit path network.

Quality of Service - Availability v. Reliability

- ILECs maintain .9999 availability and reliability.
- Packet networks still have latency and dropped packet issues.

CALEA, Universal E911 coverage and other “public safety” requirements

- Public Safety requires high levels of availability and reliability.
Price Cap Entities compared to Rate of Return Entities

Price Cap Entities

Characteristics typically high density customer percentage areas with some low density areas

Have bundled service offerings – loss leader services and high margin services

Subject to very little regulatory oversight

Their customers typically are net contributors to USF.

Those customers remit non-appropriated, regulatorily-controlled funds.

Those funds have a politically-expressed and regulatorily-directed purpose.

That purpose is to support universal access to basic telecommunications services.
Price Cap Entities compared to Rate of Return Entities (cont.)

Rate of Return Entities

Characteristics typically small, rural, low density and carrier of last resort

Services regulated with defined profitability

Limited capital accessibility

Competition typically wireless

Rely on support funding to offset high costs of service
Regulators tend to regulate those that they can – the rural ILECs

Small rate-regulated ILECs

- Financially cannot afford to give up statutory protections afforded carriers of last resort.
- Revenue requirements met by tariff rates and charges and offset funds.
- Offset funds (USFs) are quid pro quo for carrier of last resort responsibilities.
- High up-front costs associated with low-density infrastructure build-outs
- Failure to offset would run counter to policy of affordable services at reasonable rates.
- A hodge-podge of individual states’ statutes and methodologies exists regarding support.
- Unfunded support requirements are analogous to an unfunded mandate.
- Funding may go away if tied to a tax that can be earmarked.
- Funding should be specific, purpose-directed and non-appropriated.
Dedicated Circuit Architecture
v.
Packet (Broadband) Architecture

Evolution v. Technology Upgrades

A large embedded investment in current circuit-switched interconnected networks is based on regulators’ direction and public policy objectives to date.

Public policy is starting to move toward promotion of circuit-switched networks evolution to broadband packet-switched networks.

Cost to Provide is inversely proportional to Density

The Rural Argument – It Costs More!

State of the Art v. Planned Obsolescence

Recovery of embedded network investment – retiring recovered network components

Investment and updates to new broadband network components
Incentives v. Maintaining a Debt Load

Perpetual Debt v. Recovery

Not necessarily cost effective to upgrade technology that is not state of the art.

- Management philosophy and discretion
- Market externalities
- Financing limitations

Profitability

- Restricted by authorized rate of return
  - Imposed debt to equity ratios
  - Incomparable to "the real world"
- Give back penalties for "over-earning"
- In a state of perpetual debt with attendant expense
- Lost opportunity costs passed on to consumers
Market Supported Recovery v. Government Directed Recovery Mechanism

Small companies typically have “spiky” investment cycles

Technology upgrades are typically flash-cut throughout operating territory

Financially significant borrowed capital investments

Large shifts in debt to equity ratios, cash flows, depreciation rates and reduced profits

Increased depreciation and interest expense

Financially stressed operating environment

Carrier of last resort responsibilities

“Cherry-picking” environment
Industry Controlled USF v. Governmentally Controlled Tax

Does public policy require maintaining a given level of technical development in order to interface with the rest of the public network?

Do policymakers need to decide whether to support the revenue requirements inherent in the continuing technical evolution of the small companies’ networks?

The questions are:

Fund the mandates?

Implement and facilitate buyout of small companies?
The Nature of Economic Subversion

When does support become economic subversion?

Political Stimuli

Money is the opiate of government

Large ILECs make an undefined profit and keep the commissions happy!

PACs, e.g., support of politicians

Support is money

States need money

Money is control
The entity that controls the money makes the rules.

Congress (or the state), by legislation, yields

a specific, purpose-directed, non-appropriated requirement,

or, an excise tax; i.e., appropriated funds that will be earmarked.

Unfunded Mandates – Compliance insures money for the states in other venues.

Congressional earmarks keep the states compliant and politically malleable.

Is the expansion of broadband a created need or a public demand?

People are creatures of habit.

Is the creation of a benefit really a tool of control?
Who is really left holding the bag for all of this?

Consumers pay for everything

All taxes, fees and costs are passed through to the consumer.

Government funding

Both appropriated and non-appropriated funding comes from consumers.

And a Good Time Was Had by ALL