





"Along the information superhighway"

Duckboy cards, used with permission

ETC Certification – a key state role

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The views expressed are the author's alone.

- Candidate goals of ETC certification
- Universal Service Trends
- FCC order recognizes critical role of states
- Questions and challenges for the states
- Relationship to larger ETC reform

Candidate goals

For ETC certification

- Procedural

- Efficient
- Transparent
- Rigorous
- Reasonably predictable
- Confidence of stakeholders

- Substantive

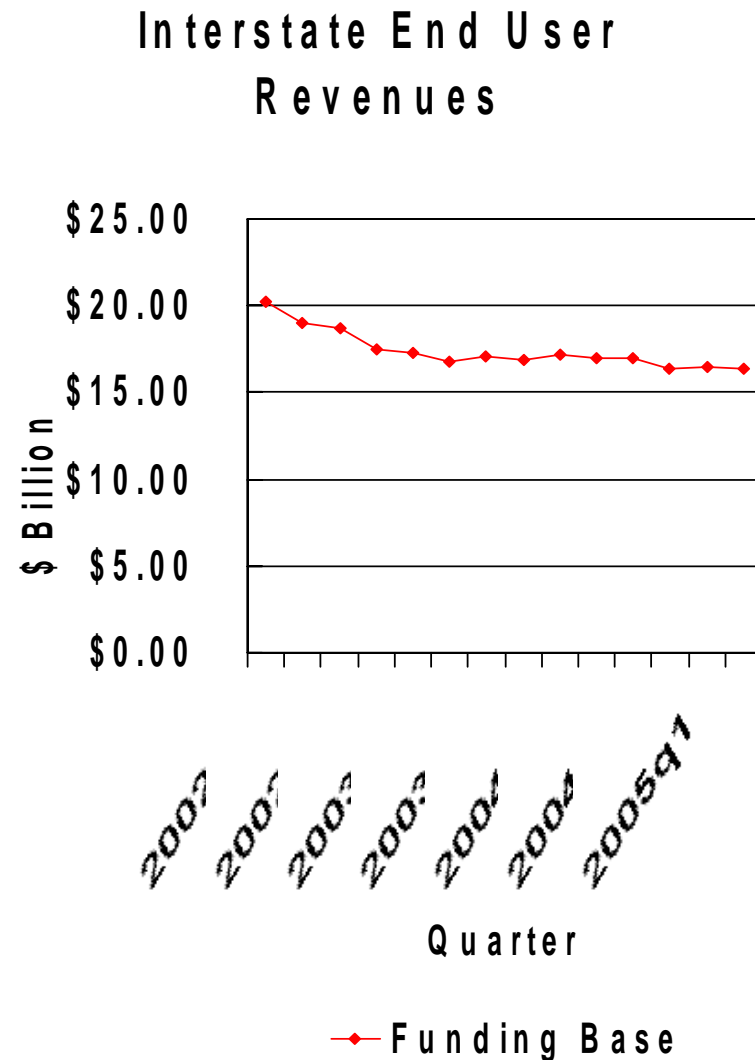
- Advancing a coherent set of public purposes
- Relationship to investment and expenditures to provide high quality service
- Long-term stability/viability of universal service
- Value to customers for support provided***

Universal service trends

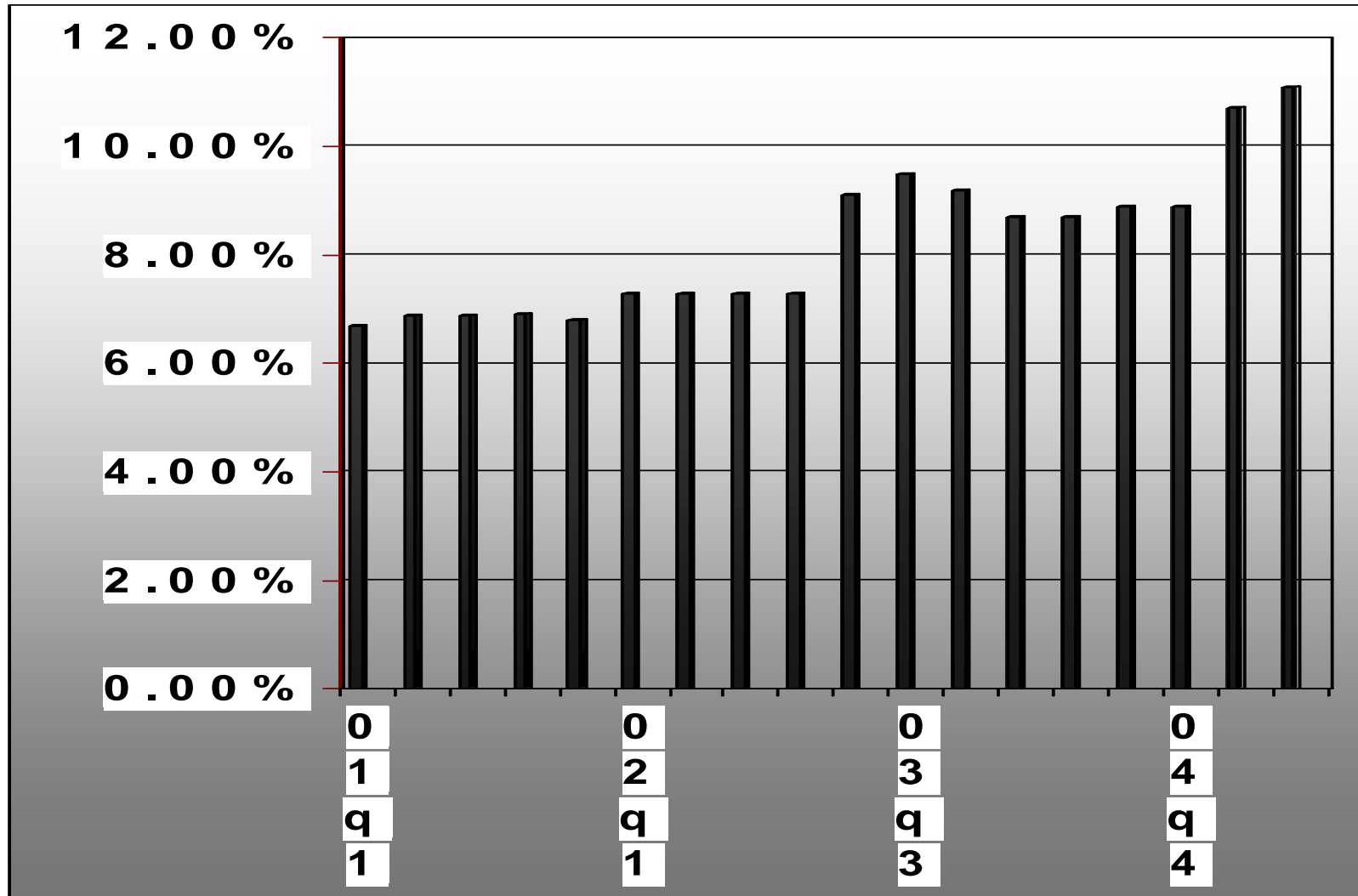
Background against which ETC certification standards were developed

Funding Base declining

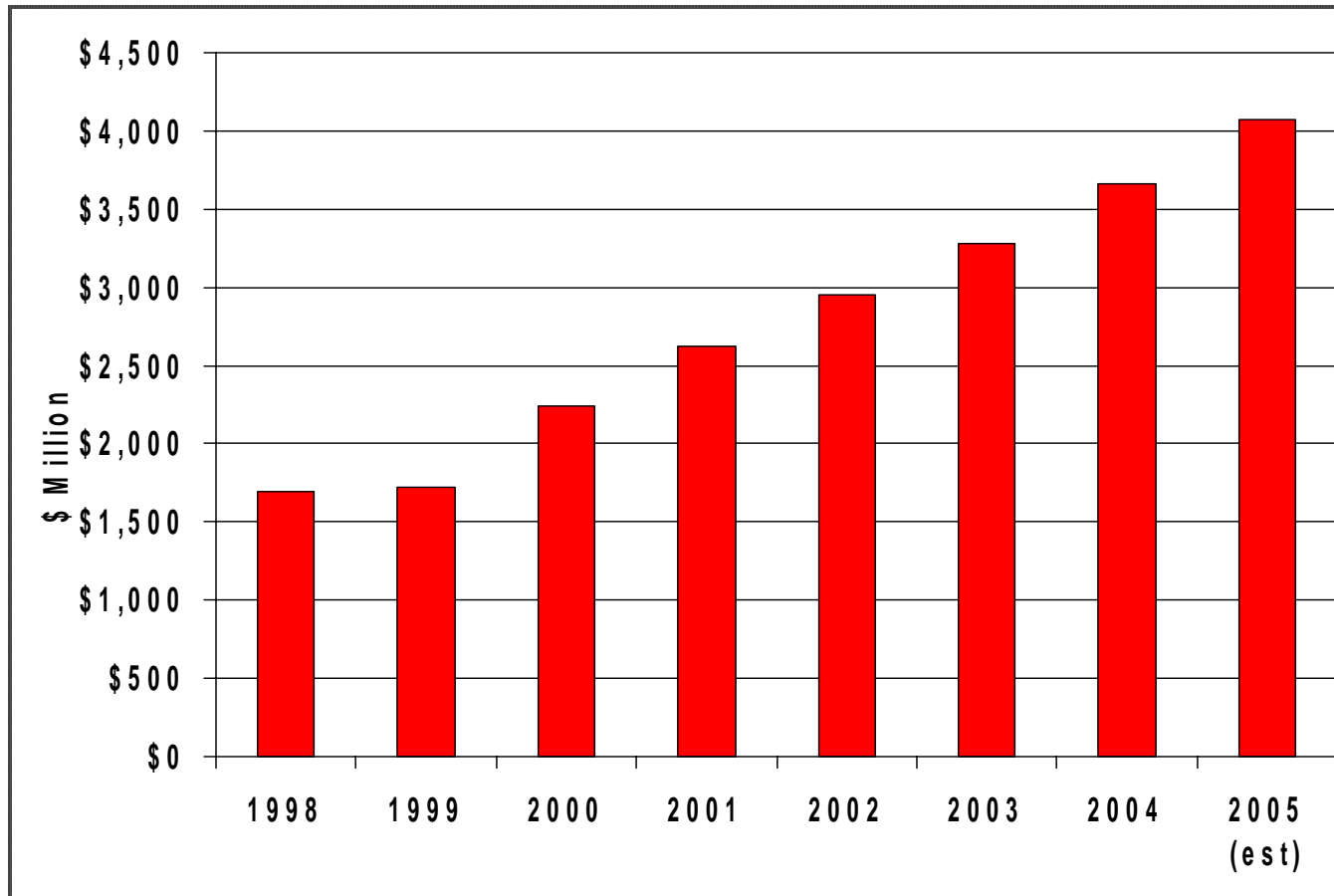
- Interstate End User Revenue base is shrinking
 - Voice over Internet
 - Bundles of minutes packages for wireless and wireline services
 - Cable telephony



Contribution Factor History

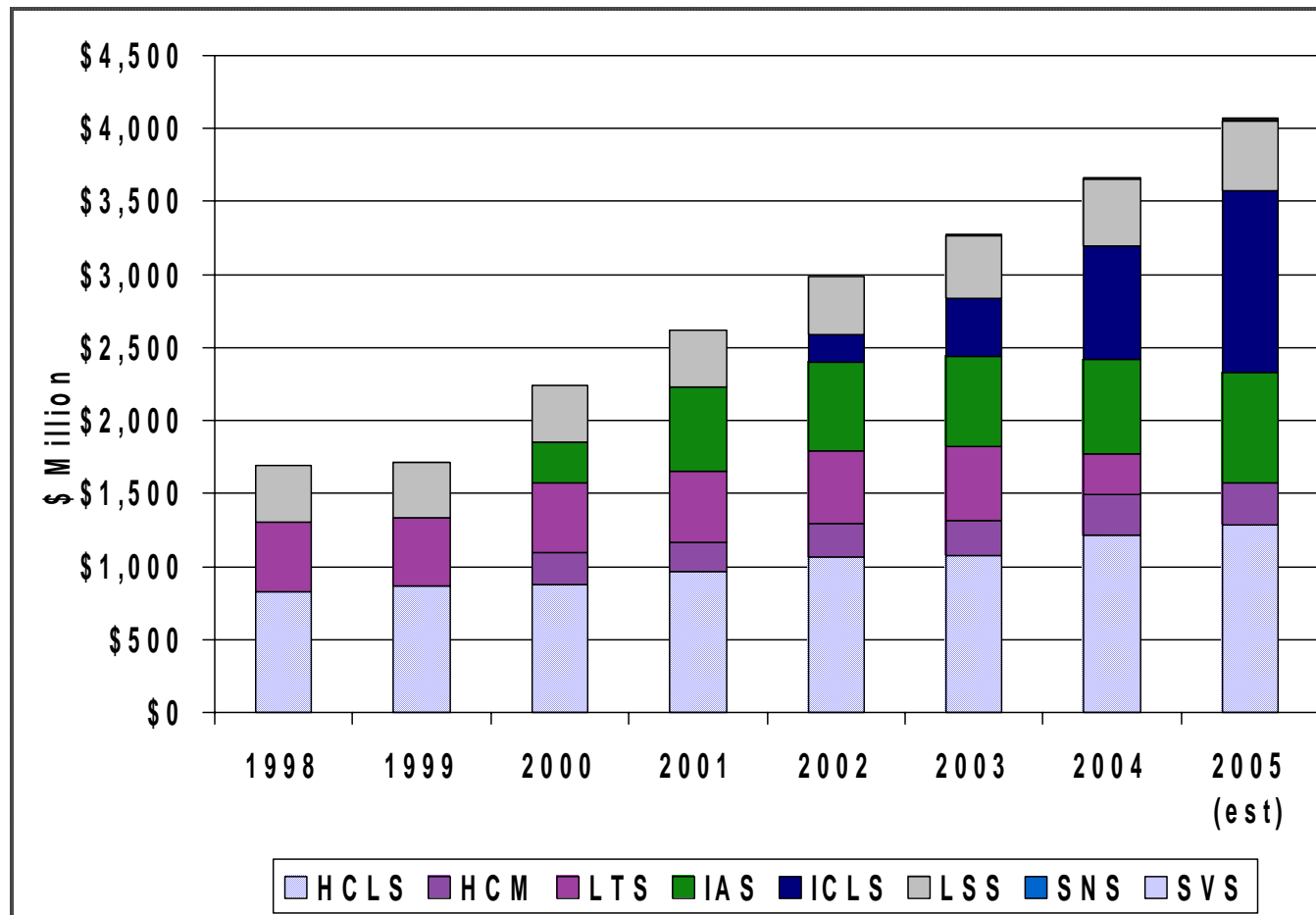


High cost fund going up



What parts are going up?

by Component (\$Million)

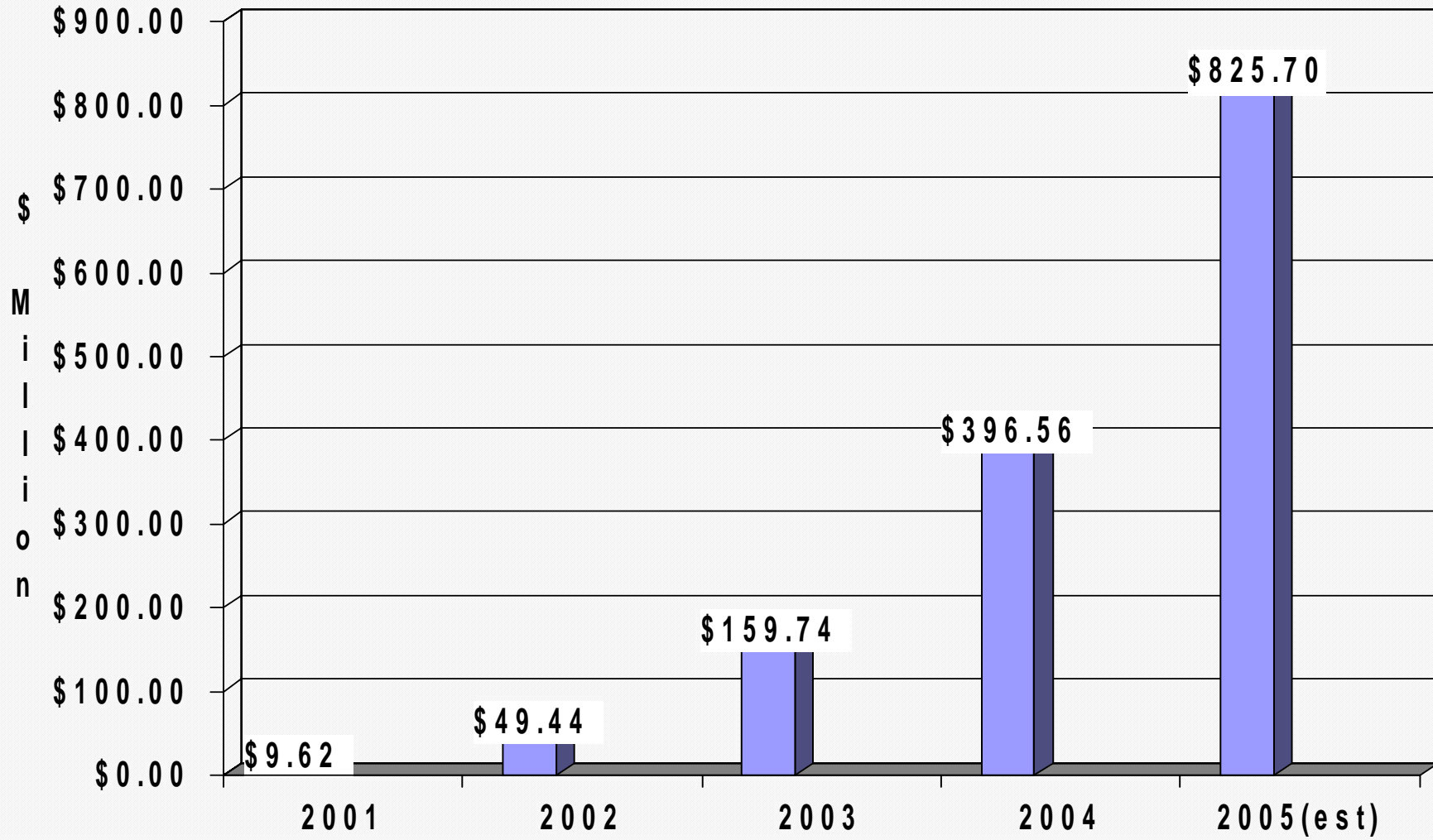


HCLS = loop; HCM = Model (large co); LTS = long term; ICLS = interstate common line; LSS = local switching; SNS = safety net; SVS = safety valve

Note: Step function increases from program changes, shift from access revenue to universal service

Source: USAC

CETC Support ramping up



Source: USAC 3Q2005 Filing

High Cost Support -ILEC vs. CETC

High Cost Fund (Annual)

	ILEC	CETCC
High Cost Loop	\$1,056.3M	\$223.8M
Interstate Common Line	959.4M	282.7M
Long Term Support	0.0M	0.0M
Local Switching Support	390.1M	85.3M
High Cost Model	221.0M	69.3M
Interstate Access	602.5M	160.0M
Safety Valve	2.3M	1.0M
Safety Net	12.7M	3.6M
Total High Cost Fund	\$3,244.2M	\$825.7M

Source: USAC 3Q2005 Filing (annualized)

***Under identical support rule, CETC support mirrors ETC support,
Including access and safety valve/safety net***

Rural CETC Growth

	3Q2002	3Q2005
Rural CETCs	26	161
Rural ILEC Study Areas with/CETCs	221	747
% of Total Rural High Cost Support	3.0%	17.8%

Source: USAC 3Q2005 Filing

*“Going up!”:
Number of CETCs
Study areas with CETCs
% of support to CETCs*

Top 10 CETC recipients

(millions per year)

Company	Approved	Pending	Total
Alltel	127.6		127.6
U S Cellular	43.4	19.0	62.4
Western Wireless	58.1	2.0	60.1
Sprint	24.2	31.3	55.5
RCC	45.3	1.4	46.7
Dobson	10.1	35.4	45.5
Centennial	39.0	1.8	40.8
Cellular South	38.6		38.6
At&T Wireless	12.6	15.2	27.8
American	12.6	15.2	27.8
Totals	417.9	120.6	538.5

Source: USAC Report HC01 2Q05

CETC per line support exceeds RLEC

Per line per month for selected states 3Q2005

State	Rural ILEC	Rural CETC	Comment
Arizona	\$ 21.03	\$25.07	Smith Bagley
Colorado	\$30.49	\$36.68	Average- NE Colorado Cellular and Western Wireless
Iowa	\$ 8.17	\$ 18.02 \$12.11	Western Wireless Midwest Wireless
Oregon	\$16.34	\$34.10 18.09	RCC Minnesota US Cellular
South Dakota	\$28.93	\$34.05	Western Wireless
Wisconsin	\$8.56	\$16.76 \$ 9.64	Midwest Wireless US Cellular
Wyoming	\$43.35	\$45.34	Western Wireless

Source: 3Q2005 USAC Quarterly Submission Appendices HC01 and HC05

- High cost fund currently over half of universal service, but other elements are significant.
- *Past* high cost fund growth associated with program changes including access reform – but little new money to ILECs.
 - Most changes (not all) did not generate new revenue for ILEC ETCs; rather, replaced access revenue with universal service.
- *“Going down!”*:
 - 12% of all rural study areas no longer receiving USF due to the Fund Cap
 - Number of study areas becoming ineligible is increasing Every Year and will over 14% by 2006
 - Nearly 33% of RLEC lines eligible for USF in 2001 are no longer receiving support
 - Number will be approaching nearly 40% by 2006 based on current NACPL / fund cap trends

- Number of Competitive (97% wireless) ETCs increasing, with presence in more study areas.
 - Under “identical support rule” they also receive access-replacement support, although they did not receive access.
- *Current* fund growth associated with increase in CETC funding.
 - So far, largest CMRS carriers (e.g. Verizon, Cingular) have largely (not entirely) refrained from seeking CETC status, but pressure is mounting.
- Confusion over universal service purposes – promote rural service and investment, promote competition, support mobile wireless access, or all?

*FCC order recognizes
critical state role*

Eligibility to receive support

- Joint board recommended standards for FCC ETC approvals/guidelines for states
- Until recently, strong federal pressure on states for liberal CETC approval.
 - Counter intuitively, some states more disciplined than FCC, didn't treat as "free money."
 - Montana attempted ETC rulemaking, started before FCC order, recently adopted with modifications.
 - Pending Missouri ETC rulemaking
 - Chairman Martin supports rigor in determinations.
- New FCC standards/state guidelines
 - Applies to ETC certifications made by FCC itself.
 - Only advisory to states
 - FCC's goal: *To promote predictability, improve long-term sustainability, and ensure that support is paid only to fully qualified carriers committed to providing universal service.*

Eligibility to receive support

- FCC Eligibility standards
 - 5 year period to improve coverage, quality and capacity.
 - Ability to remain functional in an emergency.
 - Willingness to comply with service quality and consumer protection
 - Local usage comparable to LECs.
 - Equal access to LD carriers if other ETCs relinquish
- Applies to new ETCs now, and to current ETCs by 10-1-06
- FCC Public interest standard
 - Applies to areas served by both rural and non-rural ILECs.
 - Advantages and disadvantages of competitors' service offerings, benefits of increased choice
 - Consider possible cream skimming if study area redefinition sought (certification below the study area level)
 - Not clear impact on fund will be rigorously considered. In Virginia Cellular, Commission considered impact of the CETC designation on overall fund.
 - Few applications will have severe impact, when considered seriatim.
 - Suggest considering per line impact, or density.

- FCC Annual certification
 - Report progress on implementing 5 year plans.
 - Outage detail.
 - Unfilled service requests
 - Complaints per 1,000 lines
 - Certify compliance with applicable service quality standards and consumer protection
 - Local usage plan comparable to ILEC.
 - Equal access to LD if ILEC relinquishes.
- Reconsideration of FCC order requested, seeking stronger use of FCC authority under Act.

Arguments on reconsideration (TDS, ITTA, WTA)

- Scope of Obligation to Serve
 - Designated Area Sec. 214(e) requires carriers designated to receive USF support to offer and advertise supported services “throughout the service area for which the designation is received”
 - Five-year “network improvement plan” need not show full coverage throughout the designated area *at any time*
 - Carriers are obligated to serve requesting customers within designated area only when “service can be provided at reasonable cost”
- Redefinition Petitions
 - Sec. 214(e)(5) permits redefinition of a rural study area only where both the state *and the FCC* agree to redefine the service area
 - The FCC failed to fulfill to independently evaluate whether redefinition of a rural study area would serve the public interest
 - *ETC Order* approved redefinition of rural study areas without applying public interest standards the FCC had determined should be considered

Arguments on Reconsideration, cont'd

- Permissive (not mandatory) guidelines for states.
 - The decision not to mandate that guidelines be followed undermines the statutory requirements that support be “predictable and sufficient” and provided only to eligible carriers
 - As with TELRIC, the FCC must set guidelines to ensure that state regulators fulfill their obligations under § 214(e)(2) in accordance with the statutory requirements
- Impact on the Fund
 - Insufficient guidance concerning how to evaluate individual ETC petitions within a larger framework that considers the overall impact of such petitions on the USF
 - Possible approaches that recognize the need to control USF expenditures
 - Per-line benchmarks
 - No designation of wireless ETCs in study areas where support is limited to mechanisms designed to replace lost access charges

*Questions and challenges
for the states*

- Adequate state law authority
 - As to ETCs generally
 - As to CETCs
- Verbatim adoption of FCC guidelines
- Guidelines as a floor
- Uniform standards for all ETCs
 - Different standards for CETCs
 - Different standards for wireless CETCs
- Federal or state law caps or constraints?
- Rulemaking v. adjudication?

Rulemaking v. adjudication

- Traditionally, legislative v. judicial.
- Present and past v. future.
- Holmes, Prentis v. Atlantic Coast (U.S. 1908).
Adjudication of liabilities on present or past facts.
Legislation “looks to the future and changes existing conditions.
- General applicability to all members of a broadly defined class, Burger, dissent, American Airlines v. CAB (U.S. 1966)
- Federal APA – rulemaking “future effect,” but particular as well as general applicability, including rates, wages, prices. 5 U.S.C. 551(4)

Benefits of rulemaking

- Efficiency
- Certainty
- Effective way to implement statutes
- Better use of resources with mixture of adjudication and rulemaking than with adjudication alone

Unsolicited advice to the work group

- Monitor state activity
- Identify states not empowered to act, where authority must be granted or FCC action required
- Identify and disseminate differing approaches
- Data bank of rules and orders
- Forum to deliberate approaches, provide greater clarity about high cost fund purposes
 - Consider presentations or comments to FCC, Joint Board
- Lower transaction costs/information hurdles for state ETC actions
- Help states reach better, more rigorous results

*Relationship to larger USF
reform*

*“It’s all about the
network”*

Networks are expensive.

Services deployed over high-quality
networks are relatively cheap.

Three high cost fund programs

■ RLEC rural program

- Embedded cost basis, requires investment before receiving support.
- Little “new” money, support for many carriers declining due to caps and formula.
- ILEC support overall grew 0.4% overall in '04, estimated to grow 0.6% in '05, but many RLECs losing significant amounts year-over-year
- Producing good results for customers
- Modify to fix specific problems, ensure support is adequate.

Three high cost fund programs

“Non rural” program

- Better: Large companies serving rural areas.
- Forward looking costs
 - Model flawed and not maintained
- Program twice rejected by 10th Circuit
- Often not achieving Act’s purposes
 - Reasonable comparability
 - Sufficiency
- Reform consistent with court’s direction.

Three high cost fund programs

De facto separate CETC program

- 97% wireless
- Support based on another party's costs.
 - Allows business plans based on "regulatory revenue," contrast regimes based on actual investment (rate of return).
- Rapidly growing, even with Verizon staying out – so far.
 - Grew 153% in '04, estimated to grow 116% in '05.
- Confused purposes, little discipline.
- Producing good results for shareholders in certain companies.
 - Reform to clarify purposes, increase accountability and discipline, produce results for customers.
- Can states use certification to link with results, preserving program for customers and recipients alike?

Important notice before proceeding!

I love my (unsupported) wireless phone! It is a nearly complete substitute for LD *service*.



Mobility is a great complement to my landline access!

Let's be clear, focused and honest about what we do with the CETC program!

Selywn on wireless substitutability

- Dr. Lee Selwyn is primary expert for Western Wireless in ETC matters.
- Selwyn in 9-29 2003 testimony before Utah PSC concerning Qwest.
- *“Wireless service is not a substitute for Qwest’s wireline exchange services and does not constrain Qwest’s pricing of its local exchange services.”* (p. 56)
- Different functionality – *“persistent distinction between the markets”* p. 58
- Different service quality – wireless SQ *“notoriously problematic.”* p.58
- Different scope and pricing – long-term contracts, cancellation policies, extra charges. p. 58-9.
- Different cost structure –
 - No terminating access within MTA gives advantage over IXC
 - *“Any direct comparison of the pricing charged today by CMRS providers versus the wireline providers such as Qwest for their bundled offerings (including toll) are distorted by that artificial cost advantage enjoyed by the CMRS providers.”* p. 60

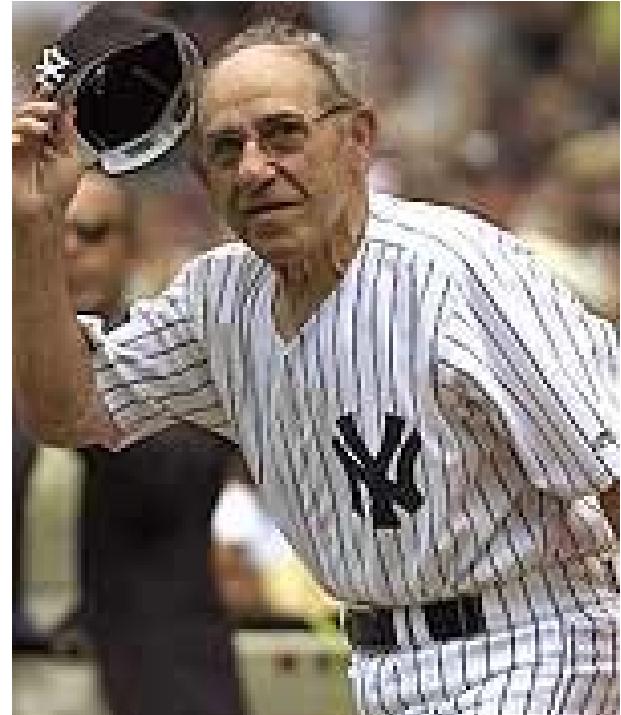
Source: Utah PSC Docket 03-649-49, Direct Testimony of Lee Selwyn

Wireless ETC program?

- *To date*, Selwyn's testimony suggests wireless is more service substitute/wireline complement, rather than primary line access substitute.
 - Note: Line loss and revenue loss are real
 - "IMHO" wireless does constrain wireline pricing more than suggested by Selwyn in '03. Nonetheless . . .
 - Wireless CETC customers generally keep their landline (contrast other CETC customers).
- Hard to justify massive wireless CETC payout, not tied to investment, as "promoting competition"
- Consider separate wireless CETC program.
 - Support infrastructure actually provided by CETC.
 - Based on own cost (embedded or FLEC)
 - Focus on goals appropriate to a wireless program. E.g.:
 - Build-out
 - Capacity
 - Reliability.
 - Possible cap or other discipline.
- Other ways to achieve discipline.
 - Limit by per-line cost or line density
 - Limit to one wireline and one wireless

Yogi Berra on ETC policy

“You got to be careful if you don't know where you're going, because you might not get there.”



About Balhoff & Rowe

Balhoff & Rowe, LLC, is a specialized professional services firm focused on providing financial-regulatory advice. The principals have nearly 30 years of experience in advising investors and regulators on complex investment issues. They have provided services to a wide range of communications companies, including incumbents, competitive carriers, wireless operators and cable operators. Additionally, the firm has expertise in energy and other utility services.

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Michael J. Balhoff, CFA, is managing partner at Balhoff & Rowe, LLC. Previously, Mr. Balhoff headed for 16 years the Telecommunications Equity Research Group at Legg Mason, which advised investors about equities in media, cable, wireless, telephony, communications equipment and regulation. Prior to joining Legg Mason in 1989, Mr. Balhoff taught at both the graduate and undergraduate levels. He has a doctorate in Canon Law and four master's degrees, including an M.B.A., concentration in finance, from the University of Maryland. A Chartered Financial Analyst and a member of the Baltimore Security Analysts Society, Mr. Balhoff has been named on six occasions as a *Wall Street Journal* All-Star Analyst for his telecommunications recommendations. His coverage of telecom was named by *Institutional Investor* as the top telecommunications boutique in the country in 2003. He has also testified multiple times before congressional committees, is regularly a featured speaker at conferences for investors and policymakers, and is widely quoted in the media, including television, newspapers as well as communications and business journals.

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Future Joint Board member avoiding tedious ex parte presentations