



*Getting it Right: Coordinating Policy
Approaches for Rural Telecom*

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- ◆ Two-part presentation today
 - ▶ Financial community perspective about integrity/principle of rural regulation
 - ▶ Victor Glass on specific threats and reforms
- ◆ Message—Rural telephony issues
 - ▶ Have not been sufficiently studied and understood after the 96 Act
 - ▶ Need immediate examination in light of fundamental threats
- ◆ Legacy system based on relatively simple policy goals
- ◆ Since Telecom Act of 1996
 - ▶ Policy goals for multiple conflicting constituents
 - ▶ Turbulent process in defining systems
 - ▶ Buffeted by rapid technology changes
 - ▶ Limited financial inputs
- ◆ Coordination of policy approaches
 - ▶ Definition of partners in setting approaches
 - ▶ Willingness to re-examine roles
 - ▶ Setting more precise goals with metrics
- ◆ Rural policy changes
- ◆ Summary and questions

- ◆ Perspective of financial community
 - ▶ Admittedly limited view of your challenges
 - ▶ Insights of parties investing (or not) in industries
 - ▶ Arguably a view more important in deregulated world
 - ▶ Legg Mason focus on RLECs
- ◆ Begin with a personal observation based on . . .
 - ▶ Testimony to Congress on sustainability of USF
 - ▶ Personal reflections
 - Legacy system actually worked, but is at risk because of changes
 - Legacy USF system focused on clear goals and metrics
 - New ETC discipline not based on clear goals, and has no metrics
 - Problem if politics compromises without concern for financial realities
 - More fundamental inputs needed to set good long-term policy
 - ▶ Major disruptive issues remain intercarrier compensation and USF
 - ▶ Subtler issue related to goals and approaches in “Getting it Right”

Legacy Policy for Rural Telecom

- ◆ 1934 Communications Act served a simpler world
 - ▶ FCC replaced the Federal Radio Commission
 - ▶ Goals
 - Making available wire and radio communications to all people in U.S.
 - Providing for national defense
 - Promoting safety of life and property
 - Securing more effective execution of policy thru centralized authority
- ◆ Systems developed over 60 years, including . . .
 - ▶ Universal service
 - ▶ CALEA
 - ▶ Lifeline
 - ▶ Simple financial system involving separations and rate regulation
- ◆ Well-defined metrics monitored in a monopoly system
- ◆ Basic pact between policymaker and monopoly carriers
- ◆ Room for error with cross-subsidies

Telecom Act—More Complex

- ◆ '96 Act “to secure lower prices and higher quality services for . . . consumers”
 - ▶ Promote competition
 - ▶ Reduce regulation
 - ▶ Encourage rapid deployment of new telecom technology
 - ▶ Preserve and advance universal service
- ◆ New goals are more complex than legacy goals, often reflecting fuzzy logic
 - ▶ More “competitors” not interested in pact, arguing over imprecise definitions
 - ▶ Regulation appears to be more extensive and expensive—maintaining obligations, adding others, while removing monopoly protections
 - ▶ Regulation does not appear to be driving technology
 - ▶ Cross-subsidies are intractable
 - Continuing as part of public policy
 - But arbitrated in “competitive” world
- ◆ Process itself has become more complex
 - ▶ Directional shift toward federalism—legal and technological
 - ▶ Errors in regulatory design can result in serious value destruction and/or arbitrage
- ◆ Rural goals and systems are generally unexamined
 - ▶ Perceived (and legislated) as different from RBOCs
 - ▶ Rural RBOC issues are undefined
 - ▶ Insufficient reflection on resolving competition v. USF polarity
 - ▶ No federal alternative regulatory model

Rapid Technology Changes

- ◆ Technology is changing landscape
 - ▶ Clear and forceful shift in subscriber base
 - Wireline declining—ILECs report serving approximately 150 million lines
 - ◆ RBOCs experiencing 4% annual decline in lines (with UNE-P losses, decline is 7%-8%)
 - ◆ RLECs losing lines at a rate of 1%-2% annually
 - Wireless growth—166 million subs (10%-13% annual and 3% sequential growth)
 - Broadband services—now about 20% penetration (15% sequential growth)
 - ▶ Pending voice over IP, possibly taking 6% share annually
 - ▶ ILECs are behind the technology curve
- ◆ Investors believe that regulators are focused on legacy approaches
 - ▶ Wireless & broadband are different from ILECs & regulated as uncompetitive, but investors judge them as competitive *because* they are different
 - ▶ Access bottleneck may actually prove to be broadband services
 - Voice-over-copper access is likely not the bottleneck
 - Broadband appears to be the bottleneck based on growth statistics
 - Competitive outlook is clear to investors, unfolding in wireless and VoIP
 - ◆ Telephony rates will drop sharply—Vonage is only the tip of the iceberg
 - ◆ The kinds of services and the functional control by consumers will expand
 - ◆ ILEC copper line losses will mount rapidly and revenues fall more quickly
 - Danger of new monopoly—perversely, regulators could be inhibiting competition
- ◆ Policymakers are having trouble keeping up with technologies

Coordinating Policy Approaches

- ◆ Coordination is a working relationship among new players
 - ▶ Policymakers
 - ▶ Consumers
 - ▶ Cross-industry participants
 - ▶ Financial community
- ◆ Involves re-examining roles/systems
 - ▶ State v. federal
 - ▶ Approach to downsizing regulatory role
 - ▶ Regulatory controls migrating toward financial controls
- ◆ Disciplined plans
 - ▶ Sharply defined goals that are achievable
 - ▶ Metrics to monitor progress
 - ▶ Financially sound commitment to networks of the future
 - ▶ Parity in regulatory approach to similar services
 - ▶ Plan for deregulation consistent with the 1996 Act
 - ▶ Recognition of situations in which the Act is not applicable

Rural Policy Changes

- ◆ Examination of goals
 - ▶ Sharper definition of rural services and goals, including those in RBOC regions
 - ▶ Evaluation of principles of competition v. USF
- ◆ Near-term challenges are daunting
 - ▶ Stability of universal service—to achieve reasonably comparable services/rates
 - Interstate and intrastate sources
 - Obligations to USF support by other communications providers
 - Recipients of USF where there are market inefficiencies
 - ▶ Portability of USF—competitive eligible telecom carriers
 - Outgrowth of RTF Order of May 2001—is mobile wireless “competitor” of wireline?
 - Federal-State Joint Board recommendations, including primary line, “paper over” problem
 - Inadequate financial analysis of CETC “discipline”
 - ◆ Shift from fixed investment approach to variable revenue in the payouts to CETCs
 - ◆ Current absence of real goals and requisite monitoring approaches
 - ◆ Issue of 47 USC §54.7—Carrier shall use USF only for provision, maintenance, and upgrading of facilities and services for which the support was intended
- ◆ Getting it right
 - ▶ Commitment to analyze goals/threats, based on defensible policy/financial principles
 - ▶ Recognition of clear legacy policy that networks bring value when predictably available
 - ▶ Cross-subsidization issues are thorny but appear central to analysis of rural industry
 - ▶ Analysis should involve structural consolidation and probable RBOC divestitures
 - ▶ Key input: policymakers, industry, consumers, financial community
 - ▶ Regulation is, and likely should be, based on treatment different from RBOCs

- ◆ Legacy system was simple/effective approach based on . . .
 - ▶ Goals
 - ▶ Metrics
 - ▶ Fewer variables and players
 - ▶ Primary control of the policymakers
- ◆ New competitive system for at least the urban markets . . .
 - ▶ More complex, including more divergent issues
 - ▶ Requires more discipline in design or the result will be value destruction
 - ▶ Requires more dialogue with investors and industry players who know the finances
 - ▶ Technology is rapidly changing assumptions about systemic approach
- ◆ Some markets do not conform to neat competitive designs
 - ▶ System may require continuing monopoly approach because of market “failures”
 - ▶ USF and pervasive competition may be irreconcilable in some markets
 - ▶ Networks still provide value as pervasive and consistent communications backbones
- ◆ Simply stated, rural issues . . .
 - ▶ Require sharper focus on rural goals, issues and risks
 - ▶ Are systemically different from urban rules/markets as suggested by '96 Act
 - ▶ Can be hurt severely by errors or omissions in design because of arbitrage/high costs
 - ▶ Upcoming reforms will be determinative of financial health of rural telecom