

Universal Service High Cost Support: Review of Rural/Non-Rural Issues

NARUC Summer Committee Meetings
Telecommunications Staff Subcommittee
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Western Wireless®



Rural/Non-Rural Review

- Review of USF must confront Rate of Return regulation.
- Rate of Return Regulation gives ILECs powerful disincentives to operate efficiently.
- Rate of Return Regulation distorts market behavior and discourages natural market consolidation.
- Rate of Return Regulation leads to no oversight – *no one is minding the store!*



Case Study - Electra Telephone Company, TX

	Year 2002
Total Reported Access Lines	1,947
Number of Employees	4
Total Income, inclusive of USF dollars	\$3,130,112
Total Federal USF Dollars	\$1,653,797
Total Texas State USF Dollars	\$718,068
USF Income as percentage of total income	76%
Total Company Rate of Return, as reported to TX PUC	27.9%

4



Case Study - Electra Telephone Company, TX

	Year 1999	Year 2000	Year 2001	Year 2002	Change 2001- 02
Income (including USF)	\$2,774,899	\$3,177,096	\$3,181,680	\$3,130,112	-2%
Expenses	\$2,778,195	\$2,884,383	\$2,699,420	\$1,758,585	-35%
Net Plant in Service	\$4,302,603	\$4,208,490	\$3,079,951	\$2,858,713	-7%
Return After Taxes	-\$128,508	\$106,999	\$237,531	\$797,206	236%
Rate of Return	-3.0%	2.5%	7.7%	27.9%	262%
Lines in Service	1,973	2,032	1,824	1,947	7%
Employees	4	4	4	4	0%



Case Study - Electra Telephone Company

	Wireline	Wireless
Total Subscribers	1,947	3
Customer Revenue	\$47,720.97	\$74.43
Federal USF Support	\$106,403.55	\$163.95
Implicit Support	\$135,861.66	\$0
Texas State Support	\$17,600.88	\$87.12
Total Monthly Revenue	\$307,587.06	\$325.50
Obligation to Serve Entire Study Area	Yes	Yes



Lost in Translation

- One-third of all Corporate Operations expenses incurred by Rural ILECs, or \$545 million out of a total of \$1.655 billion, are above the “best-in-class” benchmark, meaning *one-third of all expenses are incurred in an inefficient manner.*
- The FCC’s expense cap on the High Cost Loop fund only excludes 23% of the Corporate Operations expenses that exceed the “best-in-class” benchmark, meaning the cap allows some *77% of the most inefficiently-incurred expenses to be included in HCL calculations.*



Lost in Translation

- *Consolidation Doesn't Pay* – the cost-based nature of the USF creates strong disincentives to consolidation and cost reduction.
- Rural ILECs between 0 and 50,000 lines receive over 75% of HCL support, while serving half of the loops.
- The average per-loop annual payment to the carriers serving between 0 and 50,000 lines is \$240, more than 4 times greater than the support paid to carriers between 100,000 and 350,000 lines.
- It pays to remain small.



Lost in Translation

- The disincentives for efficient operations are compounded by the inability or unwillingness of state regulators to scrutinize RLEC's accounts to prevent errors and misstatements.
- These system-induced inefficiencies result in USF funding requirements being bloated by as much as

\$1 billion



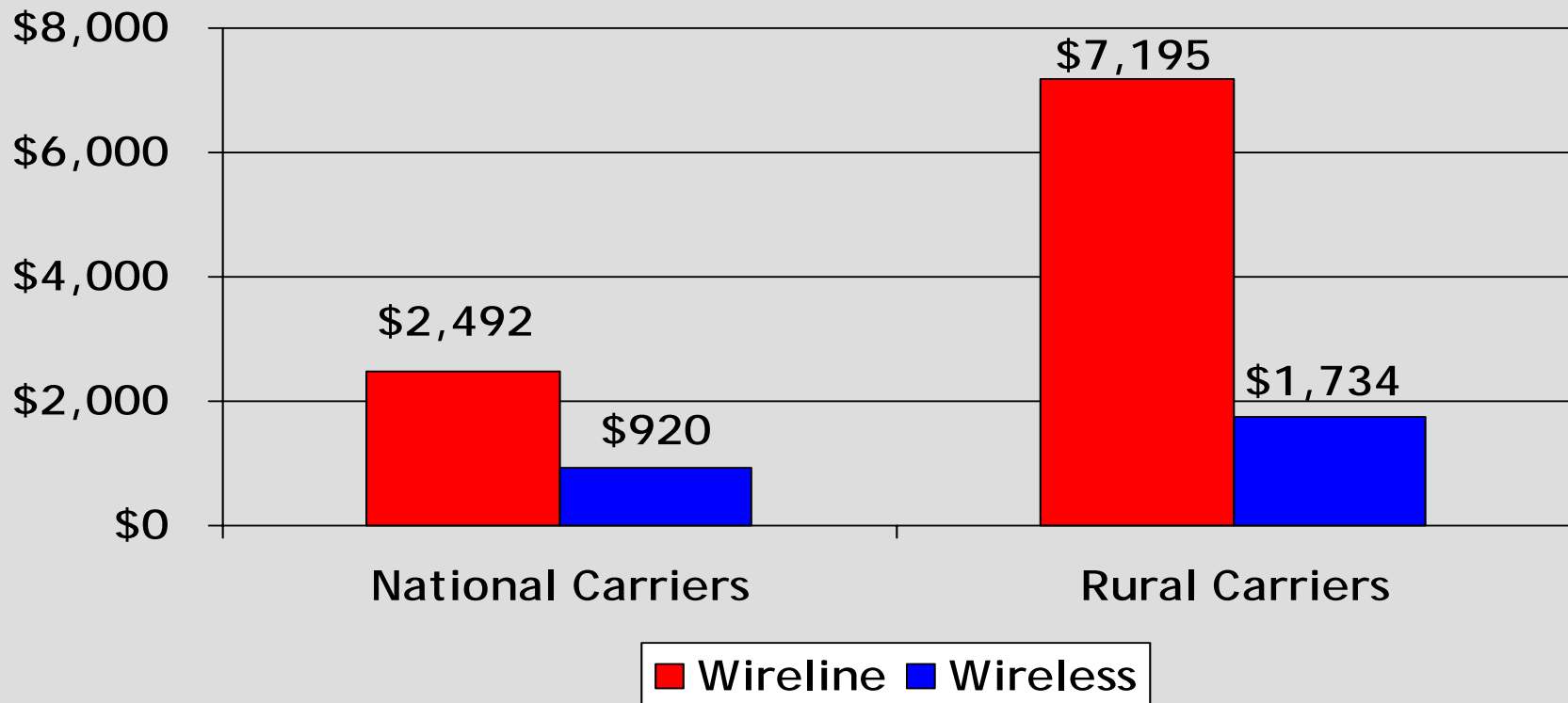
Wireline vs. Wireless Efficiencies

- Study of Wyoming and Texas Rural ILECs
- Investment, employees and operating expenses
- ILECs and National Wireline Carriers
- Compared to rural wireless carriers and national wireless carriers

10



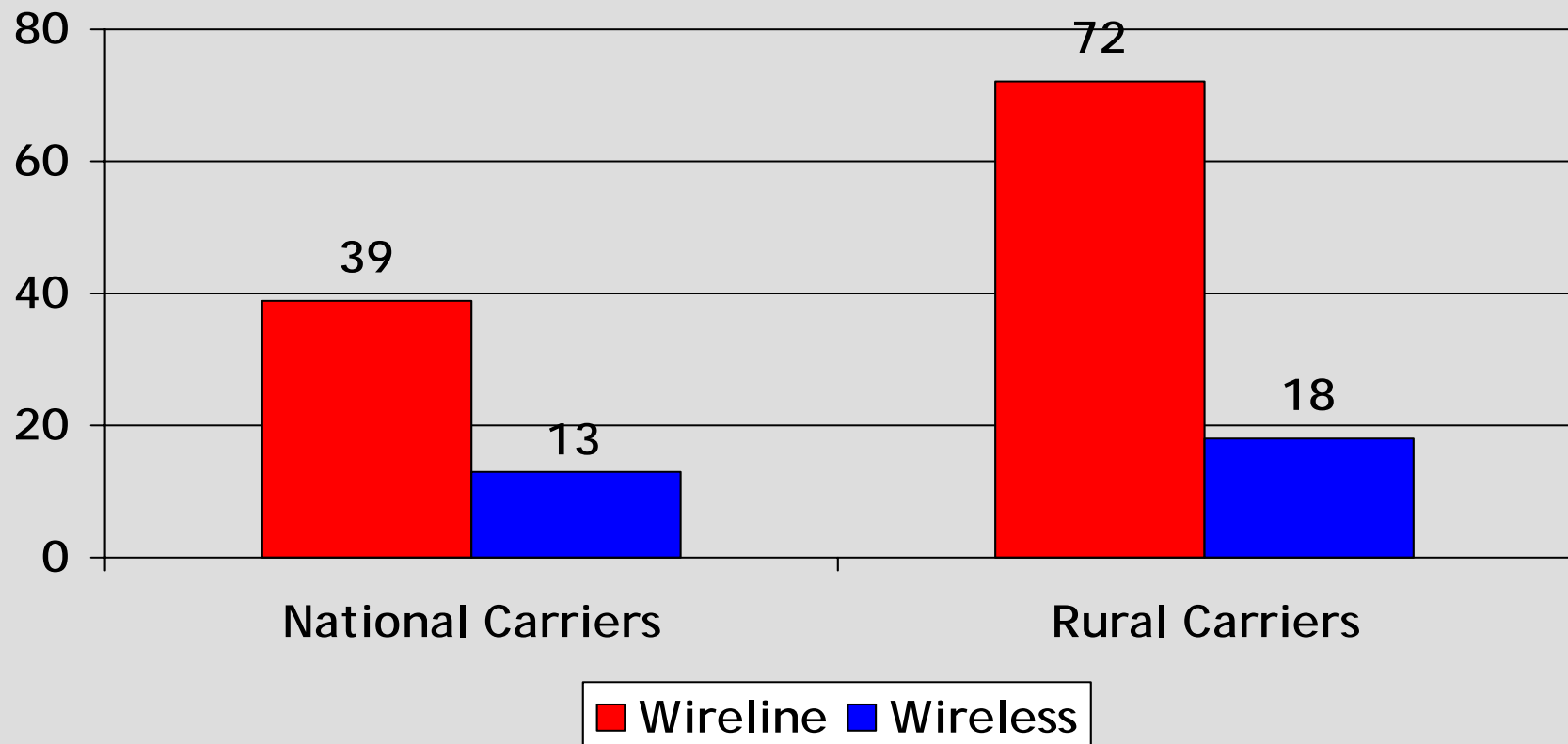
Wired service requires substantially more investment per line.



11

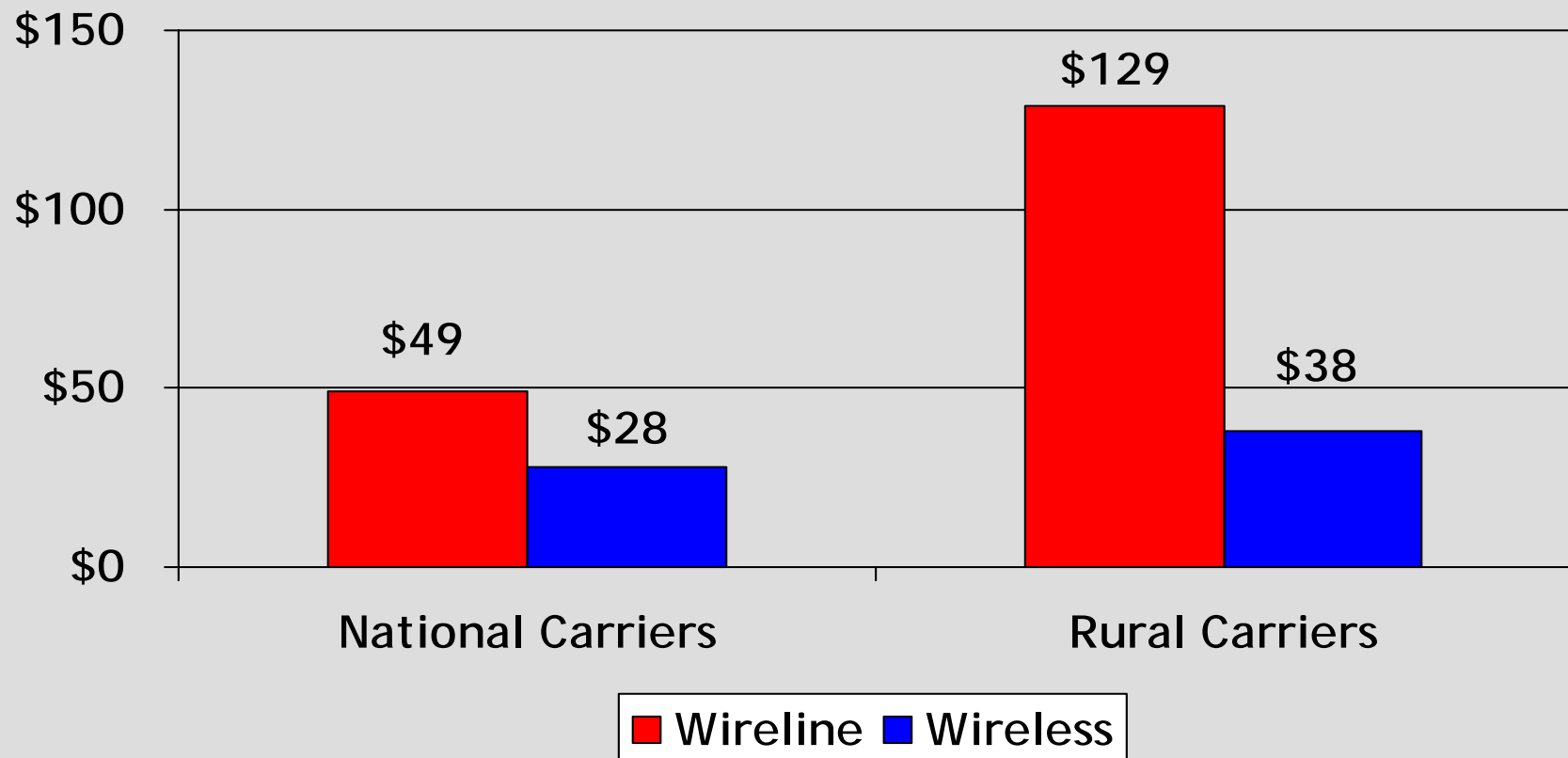


And three to four times as many employees per 10,000 customers.



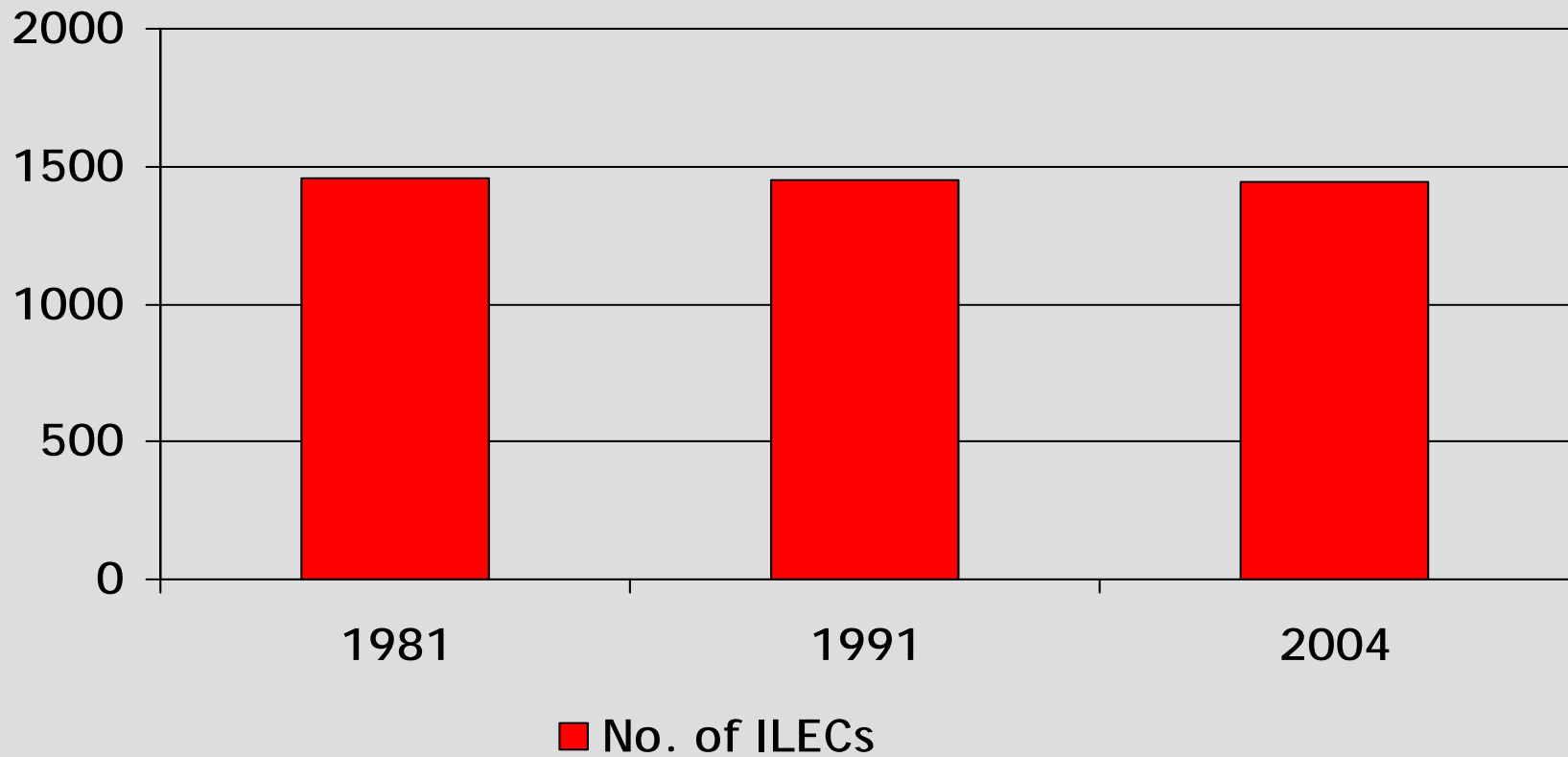


And as a result, ILEC operating expenses per customer per month are substantially higher.





And no consolidation . . .





Rate of Return Petition

- Eliminate Rate of Return Regulation
- Replace it with a competitively-neutral, market-based, forward-looking funding mechanism, whether model, price caps or something new
- Phase in the new mechanism over 8 years
- Establish a transitional “Safety Net” and “Hold Harmless” mechanism
- Reform access charges

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