Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

REPLY COMMENTS OF THE VIRGIN ISLANDS TELEPHONE COMPANY

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SUMMARY

The Virgin Islands Telephone Company ("Vitelco") provides telephone service in one of the highest cost service areas in the country. Vitelco must deal with numerous unique conditions that simply are not faced by other telephone companies: we must transport all plant over 1,000 miles by sea, inflating network costs; our customer base is spread over three separate islands, requiring duplication of many facilities; the rocky, volcanic soil of the islands prevents deployment of buried cable and increases our exposure to damage by tropical storms and hurricanes; and we are more prone to damage from corrosion by salt water than other carriers.

Despite these factors, Vitelco has achieved a penetration rate of 87.8%, which is a testimony to the effectiveness of the universal service subsidies currently in place. Even so, subscribership in the Virgin Islands is below the national average of 97%, demonstrating the need for increased levels of universal service fund ("USF") assistance.

Any change from existing USF mechanisms must ensure that support is continued -- and even increased as necessary -- for high cost areas. For these reasons, proposals to eliminate or modify existing subsidies on a flash cut basis must be rejected.

Use of mandatory cost proxy models to establish USF levels must be rejected -- the circumstances driving Vitelco's costs are

too unique to allow use of proxies, which would grossly understate the USF levels required in the islands.

In determining "affordable" rates for telephone service, the Commission must take per capita income into account. The fact that per capita income in the Virgin Islands is only about one-half of that on the mainland contributes substantially to the lower levels of subscribership in the islands. The ability of customers to pay for service must be included in the formula established by the Commission and Joint Board in setting USF levels.

USF assistance to promote advanced services should be considered in a separate proceeding. In addition, any universal service funding for health care and educational institutions should be kept separate from telephone subsidies. The public interest would not be served by making these different types of services compete against each other for universal service funding.

Arbitrary restrictions on eligibility for USF funding must be rejected. A proposal to limit USF payments to carriers with fewer than 50,000 access lines is completely arbitrary and violates the letter and spirit of the Telecommunications Act of 1996.

The Universal Service Fund should be administered by NECA, which has demonstrated the expertise, objectivity and ability to administer such a fund.

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The Virgin Islands Telephone Corporation ("Vitelco"), by its undersigned counsel, and pursuant to the Commission's Notice of Proposed Rulemaking ("NPRM") of March 8, 1996,[1] hereby submits its Reply in the above-captioned proceeding.

I. In Order To Avoid Rate Shock And Reductions In Service Levels, Existing Mechanisms Should Be The Basis For Continued Funding Of Universal Service.

Vitelco strongly agrees with the National Exchange Carrier Association, Inc. ("NECA") that the continued funding of universal service under Section 254 of the Telecommunications Act of 1996 ("1996 Act") should build upon existing funding

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[1] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 96-93, released March 8, 1996 ("NPRM"). By order dated April 1, 1996, the Commission extended the filing date for replies to May 7, 1996.

mechanisms.[2] Vitelco's experience in the United States Virgin Islands illustrates the success of these mechanisms in fostering the goal of universal service. Two factors make that goal in the islands a particular challenge. One is the fact that per capita income is only approximately one-half of the United States national average.[3] The other is that Vitelco's loop costs, which currently are almost $600 per loop, are among the highest in the country.[4] Despite these twin impediments to universal telephone service, Vitelco has been able to achieve a respectable 87.8% penetration rate, which would not have been possible without the Universal Service Fund ("USF") support. Indeed, the Virgin Islands Public Services Commission repeatedly has stated in filings before the Commission that USF subsidies have been

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[2] E.g., Comments of NECA, dated April 12, 1996, at 5-15 ("NECA Comments").

[3] United States Virgin Island per capita income in 1989 was $11,052. The World Almanac & Book of Facts 1996 at 683 (World Almanac Books 1995). That year, United States per capita income was $21,289. Statistical Abstract of the United States 1995 at 456, Table No. 706.

[4] As explained more fully infra, the extraordinary cost of outside plant construction within the Virgin Islands is attributable to a combination of factors that are unlikely to be captured by any industry cost proxies. See pp. 4 - 6, infra. Among these factors are a generally mountainous and rocky terrain and climatic conditions that feature intense sun, salt water corrosion, frequent tropical storms and hurricanes.

critical to the provision of telephone services in the Virgin Islands.[5]

This 87.8% figure, though, is still well below the national average of 97%. It is thus clear that there is an ongoing need to maintain and even increase the level of USF support so that service penetration within the Virgin Islands and other under-served areas, such as Puerto Rico and some of the less affluent States, can achieve comparability with the rest of the country. This is not simply a matter of underwriting the operations of rural and high cost local exchange carriers ("LECs"), it is a shared investment in the public switched telephone network ("PSTN") for which there is a shared benefit. The externalities created through increased penetration levels made possible by the USF thus enhance the value of the PSTN for everyone who has an interest in the network, including telephone subscribers and carriers alike.[6] Where, as in the case of the Virgin Islands, high loop costs limit the economic feasibility of affordable

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[5] E.g., letter of the Virgin Islands Public Services Commission to Secretary Caton, dated October 12, 1995 (filed in CC Docket No. 80-286).

[6] Network externalities occur where the overall value of the network is enhanced by increasing the number of persons who have access to the network. Thus a telephone network with only a handful of subscribers is likely to be of only limited value to each subscriber, but as the number of subscribers increase, its value to each subscriber will also increase. This is because an increase in subscribers obviously means that one can reach more people by phone.

local service, an underwriting of those costs to make local service affordable is in everyone's best interest.

The importance of universal service, and the successful role that existing funding mechanisms have played in promoting such service, counsel against a precipitous replacement of those mechanisms. Thus proposals, such as AT&T's proposed immediate replacement of existing mechanisms with a retail surcharge[7] and MCI's similar proposal to increase subscriber line charges,[8] would have an enormously disruptive impact on current service levels, and should be rejected. For example, "flash cut" elimination of the existing USF subsidies would force Vitelco to increase its monthly local service charges from $18.55 to over $30.00. If the carrier common line and transport interconnection charge subsidies were also eliminated, the residential service rate would rise to over $50.00. Rate shock of this magnitude undoubtedly would have an adverse impact on telephone subscribership in the Virgin Islands, driving overall penetration levels even further below the national average. The precipitous rate increases that would follow adoption of the AT&T and MCI proposals therefore clearly would disserve the public interest and would contravene the universal service goals of the 1996 Act.

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[7] See Comments of AT&T, April 12, 1996, at 7 ("AT&T Comments"). See also id. at 16.

[8] See MCI Comments, dated April 12, 1996 at 13, 14-15 ("MCI Comments").

As Vitelco discusses herein, whether the Commission orders changes in the existing subsidy mechanisms or not, universal service support for some uniquely high-cost service areas -- including the Virgin Islands -- must not simply be maintained, but must be increased. The Commission should proceed cautiously in its consideration of any possible changes in existing funding mechanisms. Any substantial departure from existing universal service funding mechanisms must ensure that high cost service areas continue to be supported, and should be phased in over a significant period of time -- five years or more -- in order to minimize disruption to the industry and rate shock to subscribers.

II. Cost Proxy Formulas Should Not Be Mandatory.

Vitelco also strongly agrees with commenters that argue NECA that the use of cost proxy formulas should not be mandatory in the calculation of appropriate levels of universal service payments.[9] As NECA correctly points out, "the cost of serving rural areas can vary greatly among small company study areas."[10] Vitelco's experience again illustrates the point dramatically.

Despite the fact that population density in the Virgin Islands is relatively high, Vitelco's per loop cost is

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[9] See, e.g., NECA Comments at 6.

[10] Id.

nevertheless among the nation's highest Among the reasons for this is the fact that the topography of the islands is largely mountainous and rocky. Of even greater significance, though, are climatic conditions. Heat, intense sun and the corrosive effects of salt water each take a substantial toll on Vitelco's outside plant. Dwarfing these effects, however is the devastating impact of hurricanes and other tropical storms. In 1989, Hurricane Hugo caused enormous damage to Vitelco's network. In order to restore service as quickly as reasonably possible, it was necessary to employ 500 temporary workers at a daily cost in excess of $250,000. The total expense for this additional work force alone exceeded $11.5 million, and that figure does not include the costs of materials and equipment. Hurricane Marilyn last year caused even more damage than Hugo, knocking out phone service to over 62 percent of Vitelco's subscribers. Over the last six months, Vitelco has restored service to its customers, but still has much work to do in repairing the full damage done to its network by hurricane Marilyn. The cost impact of these storms is obviously staggering, and is unique to Vitelco and a handful of carriers located off the United States mainland.

Further contributing to the unusually high costs of providing telephone service within the Virgin Islands is the remoteness of the islands from the United States mainland. Telephone equipment and materials must be shipped over 1,000 miles by sea to reach the islands, which increases their costs

significantly. The island's remoteness, which affects their costs of living, also forces Vitelco to pay premium salaries in order to attract qualified personnel.

In sum, loop costs in the Virgin Islands greatly exceed those that are likely to be experienced in mainland areas with comparable population densities. No party to this proceeding has proposed a cost proxy that captures the unique cost factors described above, and it is clear that, in Vitelco's case, actual costs are the only accurate and reliable measure for purposes of determining universal service requirements. Because cost proxies will understate seriously the amounts required to maintain the existing level of service penetration and to promote an increase in that level to one that more nearly approximates the national average, the Commission should reject the use of cost proxies in determining Universal Service subsidy levels for the Virgin Islands.

III. "Affordable Rates" Must Be Determined On The Basis Of Local Per Capita Income.

Section 254(b)(1) of the 1996 Act introduces into the universal service calculus the concept of "affordability": a concept with which the Commission acknowledges it lacks experience.[11] Clearly affordability is relative. It depends on

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[11] See NPRM at ¶4. See also Section 254(i) ("The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable.").

one's ability to pay. What is thus affordable in an affluent area will not be the same as what is affordable in a less affluent area. Vitelco agrees with the Puerto Rico Telephone Company ("PRTC") that per capita income is a factor that must be considered in any determination of what is affordable.[12] Otherwise, it will not be possible to achieve Section 254's objective of universal service.

Consistent with that objective, and in addition to the general principle of affordability already set forth in Section 254(b)(1),[13] Vitelco urges the Commission to exercise its authority under Section 254(b)(7), to establish nationwide

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[12] See Comments of Puerto Rico Telephone Company, dated April 12, 1996, at 11 ("PRTC Comments").

[13] In its NPRM, the Commission specifically requests comment on "how we should determine rate levels that would be 'affordable' and 'reasonably comparable' for services identified as requiring universal service support." NPRM at ¶25. In so doing, the Commission recognizes that the 1996 Act establishes two different standards: Section 254(b)(1) requires the establishment of "reasonable" rates, while Section 254(b)(3) requires the establishment of rural rates that are "reasonably comparable" to rates charged in urban areas. Vitelco notes that "reasonably comparable" rates alone are insufficient to meet the requirements of the 1996 Act. In Vitelco's experience, merely establishing rates that are comparable to those charged in mainland urban centers -- where per capita income is substantially higher -- will still place basic telephone service beyond the reach of many Virgin Islands residents. In order to promote universal service levels in the Virgin Islands that approximate those on the mainland, and in order to meet the "affordability" standard mandated in Section 254(b)(1), the Commission must take differences in per capita income into account when calculating universal service subsidy requirements.

uniformity in telephone service penetration as an explicit principle on which it and the Joint Board will base their polices for the preservation and advancement of universal service.

IV. Advanced Services Access Should Be Separately Considered.

Vitelco agrees with the United States Telephone Association ("USTA") that access to advanced services should not be included in the initial definition of universal service.[14] The question of advanced services should be dealt with in a separate proceeding pursuant to Section 706(b) of the Communications Act of 1996.[15]

In addition, if the Commission establishes health care and educational institutions as recipients of universal service funding, it should establish separate funding mechanisms for these recipients and telephone service providers. Placing all universal service subsidies into a single "pot" essentially would force health care providers, educational institutions and telephone companies to compete against each other for universal service funds. Such an arrangement would generate needless conflict among the different categories of USF recipients. Moreover, to the extent that funding for health care and educational institutions diminished the USF resources available

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[14] Comments of the United States Telephone Association, dated April 12, 1996, at 4 ("USTA Comments").

[15] Id.

to telephone companies, it would contravene the mandate of the 1996 Act to establish affordable rates for telephone service.

V. Arbitrary Caps Should Not Be Placed On Carrier Eligibility.

The Frontier Corporation proposes that a 50,000 access line cap be placed on carrier eligibility for universal service payments.[16] Implicit in its proposal is the notion that carriers that exceed this threshold serve a mix of service areas the majority of which are not rural, insular, or high cost, and that those carriers are thus able to serve high cost areas without the support of universal service payments. These assumptions are fundamentally wrong, and the proposed cap is simply an arbitrary limit on the allocation of universal service funding that is patently inconsistent with the universal service goals of the 1996 Act.

Vitelco maintains approximately 60,000 access lines, and so the proposed 50,000 access line limit effectively would eliminate Vitelco's ability to receive universal service funding. Yet the proposed cap has absolutely nothing to do with the cost of providing telephone service. While Vitelco does maintain over 50,000 access lines, its service area is spread over three separate islands. As a result, Vitelco must deploy duplicative

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[16] Comments of Frontier Corporation, dated April 11, 1996, at 6-8.

plant that is not required by a carrier with contiguous service areas. Moreover, as discussed above, the need to transport plant by ship from the mainland, the rocky nature of the volcanic islands, and the extreme weather conditions all render the Virgin Islands a high cost service area, regardless of the amount of access lines provided by Vitelco.

The 50,000 line cap proposed by Frontier would result in massive rate increases and precipitous declines in subscribership in the Virgin Islands, and so clearly contravenes the letter and spirit of the 1996 Act. In addition, because the record in this proceeding contains no evidence that a 50,000 access line cap would promote universal service, any action by the Commission adopting such a limit would be arbitrary and capricious. For all these reasons, the Frontier proposal must be rejected.

VI. The New Universal Service Fund Should Be Administered By NECA.

The Commission seeks comment on who should administer the new universal service fund.[17] Consistent with Vitelco's view that the funding of any new universal service subsidies should be based on existing mechanisms, Vitelco believes that NECA should be the fund administrator. NECA has successfully and fairly administered the existing funding mechanisms and obviously has greater experience and expertise in doing so than any other

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[17] See NPRM at ¶¶127-131.

candidate. Appointing NECA to administer the new fund would thus facilitate the transition from the old regime to the new, serve the interests of the industry, and promote Section 254's universal service goals.

VII. Conclusion

The impressive subscribership levels that Vitelco has attained in the Virgin Islands, despite the high cost of providing service, is a tribute to the universal service subsidy mechanisms currently in place. At the same time, subscribership in the Virgin Islands is below the national average, indicating the need for increased levels of USF support.

To the extent that the Commission modifies or replaces the existing subsidies, it must ensure that needed support is still provided to high cost areas. Any such changes should take place in a graduated manner designed to minimize rate shock and disruption. Similarly, any new USF mechanisms established by the Commission and the Joint Board must employ realistic measures of cost, must reflect the ability of the target customers to pay for service, and must avoid arbitrary limitations on eligibility for USF payments. Vitelco strongly urges the Commission, in conjunction with the Joint Board, to add nationwide penetration comparability as an explicit principle on which policies for the preservation and advancement of universal service will be based,

and to otherwise establish universal service support mechanisms in conformance with the discussion contained herein.

Respectfully submitted,

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May 7, 1996

CERTIFICATE OF SERVICE

I, Jonathan E. Canis, hereby certify that the foregoing *"Reply Comments of the Virgin Islands Telephone Company"* was sent, this 7th day of May 1996, by U.S. first class mail, postage prepaid, to the following:

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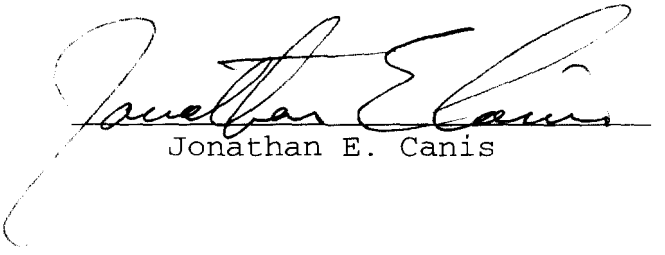

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