



Wiley Rein & Fielding LLP

1776 K STREET NW
WASHINGTON, DC 20006
PHONE 202.719.7000
FAX 202.719.7049

Virginia Office
7925 JONES BRANCH DRIVE
SUITE 6200
MCLEAN, VA 22102
PHONE 703.905.2800
FAX 703.905.2820

www.wrf.com

February 28, 2003

Bradley K. Gillen
202.719.7401
bgillen@wrf.com

EX PARTE PRESENTATION

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street
Washington, D.C. 20554

**Re: Universal Service Support For Non-Rural Insular Areas, CC Docket
Nos. 96-45, 00-256, 98-77, 98-166**

Dear Ms. Dortch:

Puerto Rico Telephone Company, Inc. ("PRTC") submits the attached written *Ex Parte* presentation concerning the above-referenced proceedings. An identical copy of this presentation was also sent to the Honorable Michael K. Powell, the Honorable Kathleen Q. Abernathy, the Honorable Michael J. Copps, the Honorable Kevin J. Martin, the Honorable Jonathan S. Adelstein, the Honorable G. Nanette Thompson, and the Honorable Bob Rowe.

Sincerely,

Bradley K. Gillen
Counsel to Puerto Rico Telephone Company

cc: William Maher
Christopher Libertelli
Matthew Brill
Jordan Goldstein
Daniel Gonzalez
Lisa Zaina



Vice President
Legal and Regulatory Affairs

February 28, 2003

The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 Twelfth Street
Washington, D.C. 20554

Dear Chairman Powell:

Re: Universal Service Support For Non-Rural Insular Areas, CC Docket Nos. 96-45, 00-256, 98-77, 98-166

Puerto Rico Telephone Company, Inc. (PRTC) respectfully requests that the FCC take action to restore the high-cost universal service support PRTC has lost, and address other regulatory issues that impact PRTC's ability to provide service. Over the last 25 years, federal universal service support has been vital to the ability of carriers serving insular areas, in particular PRTC, to provide affordable service given the unique costs and challenges of serving such areas. However, recent changes in Commission rules have reduced funding to one small subset of carriers serving insular areas – those serving non-rural insular areas. As a non-rural insular area, Puerto Rico is not subject to the same protections afforded rural areas. Yet Puerto Rico's needs are acute. Moreover, the problem is increasing – Puerto Rico is rapidly losing significant amounts of its high-cost support because of FCC policies adopted for non-rural companies that is based upon the cost characteristics of mainland companies. PRTC requests that the FCC act expeditiously to address this rapid loss of universal service support by adopting rules for insular areas that are similar to those now applied to rural carriers.

The express language of Section 254 mandates that the FCC adopts a mechanism that meets the unique universal service needs of insular areas. The FCC first solicited comments on this issue in 1999. Although it has been almost seven years since the passage of Section 254, the Commission has not yet addressed the universal service needs of insular areas. PRTC urgently needs the Commission to act on the evidence already before it, and adopt a universal service mechanism for non-rural insular carriers, as described in more detail in the attached *ex parte*.

Universal service support is vital to providing affordable service in insular areas; this is particularly true for PRTC, given its unique costs and challenges of serving all of Puerto Rico.

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Support also is required to fund needed infrastructure investment to provide modern basic local telephone service and to enable a platform that will support advanced services. However, Puerto Rico faces the elimination of approximately \$50 million in high-cost support in three years' time, a loss of funds PRTC cannot absorb. This is inconsistent with the FCC's stated desire that the phase out would gradually allow companies to adjust to the new rules for non-rural companies. PRTC's ability to invest in infrastructure improvements and modernization has been seriously impeded in part because of the decline in universal service funds. Significant infrastructure development efforts would be more likely if the correct amount of universal service funds were provided to PRTC.

PRTC's concerns remain outstanding in the Commission's pending universal service proceedings. Through comments in the *Insular Areas* proceeding, PRTC described the unique challenges associated with serving an insular area. PRTC's pending Petition for Reconsideration of the *First Report & Order* calls on the Commission to establish a universal service mechanism for insular carriers. Comments in the *MAG FNPRM* addressed PRTC's need for continued receipt of long term support. In each of these proceedings, PRTC has demonstrated the factors that make universal service support so critical to Puerto Rico.

First, companies providing service to insular areas face unusually high costs associated with providing telephone service, in particular, those that serve islands like Puerto Rico. For example, PRTC faces significantly increased infrastructure costs due to its need to ship equipment and supplies to the island. The frequent hurricanes that hit Puerto Rico also result in tens of millions of dollars of damage. Further, Puerto Rico has a highly dispersed population, particularly in its mountainous rural interior areas, where telephone penetration can be 60 percent or less. Understandably, serving an area with this combination of factors is unusually difficult and expensive.

Second, the average Puerto Rico consumer has a very low income by national standards. Puerto Rico's \$8,000 average annual per capita income is approximately half that of Mississippi, the U.S. state with the lowest average income. At the same time, Puerto Ricans face a high cost of living. Puerto Rico's 133.8 cost of living index is well above the national average of 100. This combination creates a high hurdle for PRTC to set rates that are affordable for Puerto Rico's numerous low-income subscribers, a challenge compounded by the increased costs of serving an insular area.

Third, other sources of universal service revenue are not viable options in insular areas. For example, PRTC's current revenues are not sufficient to ensure the affordability of rates and fund needed investment. It is difficult to generate enough funds from Puerto Rico sources for a

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sufficient intrastate universal service fund, given that there are relatively fewer carriers in Puerto Rico to fund such an intrastate program.

Fourth, due to the policies the FCC has adopted for the non-rural mechanism applicable to the largest telephone companies, Puerto Rico's high cost support is being eliminated, yet the record evidence requires an increase. This drop in support already has had negative effects in Puerto Rico.

The express language of Section 254 mandates that the FCC ensures the comparability and affordability of rates in insular areas. In 1999 the FCC initiated this proceeding to address universal service support for insular areas. Since initiating this proceeding, the FCC adopted a separate universal service mechanism for rural carriers. While this mechanism provides support to virtually all other insular areas, which are also categorized as rural areas it leaves Puerto Rico vulnerable because Puerto Rico fails to meet the technical definition of a "rural area." Currently, the test for universal service support for PRTC is the forward-looking mechanism for non-rural carriers. Under the Commission's forward-looking model, PRTC receives no high-cost support. Hold-harmless support for non-rural carriers, which provides funding based on embedded costs, is rapidly being eliminated. Thus, the Commission needs to act quickly to rectify this increasingly serious situation. The record in this proceeding, coupled with the mandate of Section 254, provides ample justification for the FCC to address PRTC's unique needs as a non-rural insular carrier.

Several measures are required to address the difficulties facing PRTC. First, the Commission should adopt an embedded cost mechanism for non-rural insular carriers, like that already used for rural insular telephone companies. Such a mechanism would restore PRTC's needed support, and would fulfill the FCC's mandate under Section 254. As with the rural mechanism, this approach should not be subject to reductions or any phase-down. Instead, the non-rural insular mechanism would remain in place at least until the Commission completes its planned comprehensive review of high-cost support mechanisms.

The impact of this proposed change will have only a minimal impact on the high cost fund given the unique application of a rule to non-rural insular areas. The maximum impact of the change recommended here would be less than 1.5 percent of high cost funds.

Additionally, PRTC's long term support ("LTS") must remain at current levels. If LTS is incorporated into the interstate common line support ("ICLS") mechanism, it must not lead to reductions in support. Further, under current rules, PRTC will be required to transition to price cap regulation as a result of its acquisition by Verizon. As a result, PRTC no longer will be eligible to receive LTS. What is more, the CALLS interstate access universal service fund never

