Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

COMMENTS
of
PEND OREILLE TELEPHONE COMPANY

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Introduction and Summary

The Federal Communications Commission's (Commission) NPRM[1] in the above-captioned proceeding requests comment on proposed rules intended to modify the existing rules on the Universal Service Fund (USF) and Intercarrier Compensation (ICC).

Pend Oreille Telephone Company[2] (Pend Oreille) submits these comments for the FCC's consideration. Pend Oreille is a rural telecommunications provider serving 1,941 voice access lines and 678 broadband customers in the state of Washington. The following characteristics are true of Pend Oreille:

- Pend Oreille is the Carrier of Last Resort designated by the Washington Utilities and Transportation Commission, which legally obligates the company to provide telecommunications service to all requesting customers within its service territory.

- Pend Oreille is the Eligible Telecommunications Carrier (ETC) determined by the Washington Utilities and Transportation Commission to provide universal service within the company's designated service territory.

- Pend Oreille receives High Cost Support from the Federal Universal Service Fund. This support totaled $708,234 in 2010 and comprised over 34.77% of Pend Oreille revenues in 2010. Support came from the following sources:

[1] *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13 (rel. Feb. 9, 2011) (*NPRM*).

[2] Pend Oreille service territory is in Northern Washington State. Its serves the communities of Ione, Cusick & Metaline Falls. In this service area is a military installation, mining operation, Kalispell Tribal lands.

- High Cost Loop Support (HCLS) $224,550
- Interstate Common Line Support (ICLS) $304,932
- Local Switching Support (LSS) $178,752

- Pend Oreille generates substantial revenues from providing intrastate switched access services. In 2010 intrastate switched access revenues totaled $383,881.

- Pend Oreille provides voice and broadband services to schools, libraries, rural health care facilities, governmental agencies, and/or other anchor institutions within its service territory.

- Pend Oreille is one of the, if not the, largest employers in the company's rural service territory, providing jobs and financial stability in rural areas of Washington State. In 2010, Pend Oreille employed 13 people and provided combined payroll and benefits of $ 892,868.00.

- Pend Oreille has deployed substantial financial and human resources to provide voice and broadband services under the existing rate of return rules prescribed by the FCC and by the Washington Utilities and Transportation Commission. In 2010, Pend Oreille had:

  - Regulated rate base $2,107,287
  - Long term debt $995,179
  - Annual debt payments $712,446
  - Net income $(145,558)

- In 2010 Pend Oreille had financial results that produced the following financial ratios, which are key drivers of the company's ability to borrow additional funds and the terms and interest rates under which existing loans must be repaid:

- Debt service coverage ratio[3] (0.30)
- Times interest earned ratio[4] (0.99)
- Debt/EBITDA ratio[5] 3.27

- Pend Oreille would not have had the financial resources to deploy and maintain either voice or broadband services without rate of return regulation and the support of the Universal Service Fund.

In these comments, Pend Oreille outlines the impacts that adoption of the short term USF and ICC rules, as written in the NPRM, would have on its financial results.

[3] Debt Service Coverage = Net Operating Income / (Principal + Interest on Long Term Debt)

[4] Times Interest Earned = (Net Income + Interest on Long Term Debt + Income Tax) / Interest on Long Term Debt

[5] Debt/EBITDA = Long Term Debt / Earnings Before Interest, Taxes, Depreciation, and Amortization

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I. Analysis Performed by Pend Oreille

In order to provide relevant financial context to the FCC in these comments, Pend Oreille engaged Moss Adams LLP[6] to perform a detailed financial analysis of the impacts of the NPRM. Their analysis primarily focused on the impacts of the proposed rules identified in Appendices A-C of the NPRM, which outline short term modifications to Universal Service Funding. They also analyzed the potential impacts of shifting intrastate access rates to an average interstate switched access rate[7] or $0.0007. This analysis was performed using Pend Oreille recently

[6] Moss Adams LLP (Moss Adams) is the 11th largest accounting and consulting firm in the United States, with more than 225 partners and 1,800 staff. Moss Adams' Telecom Group has served the telecommunications industry since 1957. Today, they provide audit, tax, and consulting services to more than 80 small and mid-sized telecommunications carriers throughout the United States and its territories.

[7] The interstate switched access for each company varies based on participation in the National Exchange Carrier Association (NECA) FCC Tariff No. 5, NECA rate band, and transport miles and billing percentages included in the

submitted 2011 National Exchange Carrier Association (NECA) cost study forecast, which is utilized by NECA in establishing tariff rates for its annual access tariff filing with the FCC, and other information generally available from Pend Oreille as the basis. The following assumptions were used in the analysis of the impacts of these proposed changes in USF support and intercarrier compensation:

- 2011 forecasted costs were held constant for the 4 year analysis (2011 – 2014). Given the uncertainty in regulation and drastic reductions in USF support proposed in the NPRM, Pend Oreille has delayed its plans for major capital expenditures and necessary plant improvements.

- All proposed changes to the calculation of High Cost Support were analyzed on an individual and aggregate basis. For example, for High Cost Loop Support, Moss Adams individually calculated the impacts of the phase out of Corporate Operations Expense and the reduction in support from 65% and 75% to 55% and 65%, and then calculated the combined impacts of these proposals.

- For ICLS, Moss Adams performed a standalone analysis of the impacts of phasing out Corporate Operations Expense without considering the impact that changes to LSS have on the calculation of ICLS.[8] In addition, Moss Adams performed an analysis that

calculation of the composite rate. These composite switched access rates range from $0.010598 to $0.099349 per minute of use.

[8] Part 69.306(d)(2) of the FCC's rules requires a shift of the local switching revenue requirement (typically 30%), after the local switching revenue requirement has been reduced for LSS, to the common line revenue requirement. As a result, reductions in LSS will increase the local switching revenue requirement. This increased local switching revenue requirement is then shifted (30%) to the common line revenue requirement. The increase in the common line revenue requirement, increases the amount of ICLS necessary to recover the common line revenue requirement.

included both the impacts of phasing out Corporate Operations Expense and the impacts of changes to LSS.

- Intrastate switched access minutes of use were held constant at their 2010 levels. While access minutes have been steadily declining, it was assumed that minutes will stabilize if the switched access rates decline to a composite interstate rate or $0.0007, and these savings are passed on to consumers by interexchange carriers.

- Voice access lines were held constant over the life of the analysis. While Pend Oreille has consistently lost access lines over the past several years, it is difficult to forecast the level of continuing decline. Maintaining consistency is a conservative approach, which may actually understate the overall negative financial impacts of the NPRM over the life of the analysis.

- Beyond intrastate switched access, all intrastate revenues were held constant over the life of the analysis. This includes local service revenue, special access, and state universal service funding. Again, given the consistent annual losses in voice access lines, maintaining consistency is a conservative approach, which may actually understate the overall negative financial impacts of the NPRM over the life of the analysis.

Using a wide variety of data and the assumptions identified above, the following analyses were performed based on the 2011 NECA forecast data and actual 2010 financial results:

- The effect of phasing out Corporate Operations Expense over 3 years (2012-2014) on High Cost Loop Support (HCLS).

- The effect of phasing out Corporate Operations Expense over 3 years (2012-2014) on Interstate Common Line Support (ICLS).

- The effect of phasing out Corporate Operations Expense over 3 years (2012-2014) on Local Switching Support (LSS).

- The effect of reducing the HCLS support levels from 65% and 75% to 55% and 65% at once, starting in 2012.

- The effect of phasing out SNA over a 4-year period (2012-2015).

- The effect of phasing out LSS over a 3-year period (2012-2014).

- The effect of capping total High Cost Support (HCS) at $3,000 per line per year.

- The effect of transitioning intrastate switched access rates to the composite interstate switched access rate or $0.0007 per minute of use.[9]

- The combined effect of these proposed rule changes on net income.

- The combined effect of these proposed rule changes on the ability to repay existing debt, as measured by three key financial ratios, Debt Service Coverage (DSC), Times Interest Earned Ratio (TIER), and Debt/EBITDA.[10]

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[9] While there is a proposed calculation of support under Phase 2 of the Connect America Fund (CAF) that could include recovery of certain lost intrastate revenues, the NPRM does not ensure that this intrastate revenue loss will be recovered through the CAF or some other mechanism. As a result, Moss Adams included the proposed reductions in intrastate access revenues as potential lost revenues under the NPRM.

[10] Banks that traditionally lend to the rural telecommunications industry mandate loan covenants on borrowers, which usually include TIER, DSC, and/or Debt/EBITDA ratios. While these covenants can vary between borrowers and lenders, our covenants are described above with TIER ratios between 1.50% and 1.75%, DSC ratios at 1.25%, and Debt/EBITDA between 2.0 and 4.5.

- The combined effect of these proposed rule changes on local customer rates.[11]

II. Financial Results and Findings of Moss Adams' NPRM Analysis

The results of the analyses and assumptions outlined above can be summarized for Pend Oreille as follows:

- The phase out of Corporate Operations Expense alone[12] reduces HCLS by $263,772, ICLS by $140,977, and LSS by $56,195 for a total impact of $460,944. This is a reduction in total High Cost Support of 57.29% over 3 years.

- The reduction in HCLS support from 65% of the Study Area Cost Per Loop (SACPL) above 115% of the National Average Cost Per Loop (NACPL) up to 150% of the NACPL and 75% of the SACPL above 150% of the NACPL to 55% and 65% respectively, alone reduces HCLS by $39,558. This is a reduction in total High Cost Support of 14.45% over 3 years.

- The phase out of LSS eliminates support of $177,430. This is a reduction in total High Cost Support of 64.82% over 3 years.

- The overall result of the proposed USF rule changes is a reduction in net income of $530,892, from $(145,558) to $(676,450). This results in a significant reduction in the financial ratios included in many loan covenants. The TIER ratio is reduced from (0.99) to (8.24), the DSC ratio is reduced from (0.30) to (1.05), and Debt/EBITDA ratio

[11] Presumably, increases in local rates will be the only way to recover lost USF revenues and potentially lost intrastate access revenues, as it is not clear that the Connect America Fund (CAF) will cover lost intrastate revenues.

[12] This does not include the impact of any other proposed rule changes.

decreases from 3.27 to (4.40). In addition, the return on regulated rate base declines precipitously from (6.91%) to (32.10%).[13]

- The reduction of intrastate switched access rates to a composite interstate switched access rate or $0.0007 per minute of use reduces intrastate revenue by $307,176 and $382,554 respectively. This is a reduction of 80.02% and 99.65% respectively.

- The combined impact of these proposed rule changes has a devastating impact on the company's net income. In 2010, net income was $(145,558). The result of the proposed USF rule changes, and intrastate switched access rates at the composite interstate rate, is a reduction in net income of $838,068 for a resulting net loss of $983,626. If intrastate switched access rates are further reduced to $0.0007, and there is no support for this lost revenue under the CAF or some other mechanism, net income is reduced by $913,446 for a resulting net loss of $1,059,004. There is no need to recalculate the financial ratios given these changes, as both the TIER and DSC ratios would be negative.

- As a result of these substantial reductions in revenue, with no apparent offset in support, Pend Oreille would have to raise end user rates, or reduce costs, to maintain long term financial viability. In order to recover the lost High Cost Support, Pend Oreille would need to increase end user rates, or reduce costs, by an estimated $22.79 per line per month. Residential rates for supported voice services currently average $10.00 per line per month today. This is an increase of more than 227.93% from today's average rates.

[13] The interstate rate of return authorized by the FCC is 11.25%. Intrastate rates of return vary by state and by company, but typically fall in the range of 8% to 12%.

- If the CAF, or some other mechanism does not support lost intrastate access revenues, end user rates would need to increase by an additional $13.19 with intrastate access rates reduced to the composite interstate rate per minute of use, or $4.46 with intrastate access rates reduced to $0.0007 per minute of use. Combined with the reductions in High Cost Support outlined above, end user rates would need to increase by as much as $35.98 to recover the lost revenues. This is an increase of more than 871.19% and brings the average rate for basic local service to a staggering $105.85 per month, not including the Federal Subscriber Line Charge, calling features, and taxes and surcharges.

III. Pend Oreille's Ability to Generate Cost Savings Through Increased Efficiency

Pend Oreille does not have the ability to generate significant cost savings through increased efficiency. As the designated Carrier of Last Resort in our regulated service territory, we are obligated to provide service to all requesting customers. As a result of this obligation, our ability to reduce capital investments is limited. If a customer requests service, we must build the facilities to that customer, pursuant to state and federal tariffs. In order to meet the expectations of our customers that we provide services that are reasonably comparable to those available in urban areas, we must continually maintain and upgrade our network.

In addition to the capital costs discussed above, many of our operating expenses are fixed, and certainly are not discretionary as the NPRM would suggest. The majority of our operating expenses are driven by employee salaries and benefits and depreciation expense. These employees install service, maintain the network, provide customer service, and perform administrative and management functions.

Certainly the installation of service and maintenance of the network are not discretionary functions, as the Washington Utilities and Transportation Commission maintains service installation and quality of service standards. In order to reduce these costs significantly, we would need to reduce staff, which would in turn negatively affect the quality of service that we are able to provide our customers.

Customer service representatives are responsible for assisting customers with: understanding and ordering services, solving service problems, understanding and paying bills, and many other customer facing functions. Many of these customer service functions are mandated by the Washington Utilities and Transportation Commission and/or the FCC. In order to reduce these costs significantly, we would need to reduce staff, which would in turn negatively affect our ability to assist customers in understanding services and rates.

Corporate operations expenses primarily include administrative functions, such as: regulatory accounting and auditing, legal and regulatory requirements, general management, and other administrative requirements. Many of these functions are mandated by the Washington Utilities and Transportation Commission and/or the FCC, or lenders that provide necessary capital to build the network. In order to reduce these costs significantly, we would need to reduce staff, which in turn would negatively affect our ability to manage the company and to meet many of our regulatory obligations.

Our staffing levels are designed to maintain compliance with all regulatory and customer service standards, including meeting customer and network demand and allowing for reasonable work schedules, including sick and vacation time. We believe that it would be very difficult to significantly reduce these expenses, while still maintaining the quality of service, customer responsiveness and regulatory requirements mandated by the Washington Utilities and Transportation Commission and the FCC.

IV. Conclusions

Reductions in support dollars currently received would greatly impact the services that Pend Oreille is able to provide to end users, staff and the surrounding community. The mission and vision to continue to improve and provide quality phone and data service to our customer base would be negatively impacted. Reductions to support mechanisms would require senior management and the board to consider other options due to negative operations and funding operating losses which would cause the validity of the operations to be challenged. In addition, our service area includes end users that would have no access to broadband or land line and in some circumstances, wireless telephony if it were not for the infrastructure provided by our company through support mechanisms provided by the FCC.

April 18, 2011

Respectfully submitted,

PEND OREILLE TELEPHONE COMPANY

By:
Mark Martell
General Manager
892 Madison Avenue
Glenns Ferry, ID 83623-2374
208-366-2614