

Prepared Remarks of Robert Eddy at Meeting of House Rural Caucus February 15, 2006

I would like to thank Chairman Gutknecht and the Rural Caucus for inviting me to be a part of this meeting.

NECA Introduction

I have been a member of the NECA Board of Directors since 2000 and about three weeks ago the members of the board elected me as their Chairman. Now I'd like to tell you a little bit about NECA and its role in the telecommunications industry. NECA is a not-for-profit association of local telephone companies. We were established at the direction of the FCC when the former ATT system was split, and we operate under FCC rules.

Our principal mission is to administrator the FCC's access charge plan, which was established concurrently with NECA's creation. Access charges are the fees that long distance companies pay to local telephone companies to complete interstate calls on the networks belonging to those local companies. Interstate access charges are one of three principal sources of revenue to all local telephone companies.

Telephone Company Revenue Streams and NECA Roles

I think it's important for this Caucus to understand the complex interrelationship between these revenue streams because the typical rural telephone company relies on all of them: they include access charges, universal service funding, and, of course, customers. Customers account for about 40 percent of revenues, while access charges and universal service funding each make up about 30 percent. Maintaining a reasonable balance among these revenue streams helps keep rural customers' telephone rates more affordable.

Rural telephone companies in NECA's access tariffs and pools serve about 12 million rural consumers across nearly 40% of the land mass of the continental United States. Twelve million people might seem a large number, but when you consider these 12 million customers are spread across almost forty percent of the continental U.S. in a country of about 281 million people, you're talking rural. I'll come back to this point in a few minutes.

NECA operates a settlement system to distribute access charge revenues among the more than 1200 rural telephone properties that participate in our access charge tariffs and pools. We file and defend interstate access tariffs with the FCC on behalf of these companies. NECA takes care of most of the Federal regulatory requirements for them. This enables the companies to focus on providing service to their customers.

During its long history NECA has been the well respected source of data collection, research and analysis, and revenue distribution at the heart of the rural telephone economic system. We are a primary vehicle through which member companies have provided vital telephone services to consumers at reasonable prices.

Our expertise also includes industry database management, economic forecasting, trend analysis, and regulatory policy analysis.

NECA shares the view that broadband services ought to be available to everyone in America, and soon. Our member companies are striving to provide universal access to broadband.

In this regard, it is important to note that the NECA pooling mechanism has been and will continue to be an important way to help deploy broadband to customers living in rural America. Up to now, this mechanism, in concert with universal service programs, has enabled rural telephone companies to focus on providing excellent basic service to their customers, many in the most remote places of our country.

As a result, rural consumers have long enjoyed the benefits of high quality voice grade service. Many of them have access to broadband connections, but not all of them. Some parts of rural America are so remote that it can be prohibitively expensive to provide basic voice grade service, let alone broadband.

NECA's pooling processes enable rural companies to spread the cost of providing interstate access, and make it possible to serve even the most remote places. Universal service funding also helps phone companies provide voice grade telephone service in these high-cost areas.

For the last 23 years NECA has helped companies focus on providing reliable voice grade service at reasonable prices to their customers. Now we can help these companies focus on deploying state-of-the-art broadband as well.

NECA Role in Universal Service

In addition to our role in managing access tariffs and the flow of funds between carriers, NECA has had a role in managing universal service programs.

Prior to the 1996 Telecom Act, NECA was the administrator of the universal service fund. After the Act went into effect the Universal Service Administrative Company - or USAC - was created to administer USF.

Today, NECA is still responsible under FCC rules for collecting high cost loop data from all local telephone companies. That data is used to calculate the national average loop cost and determine payments for qualifying carriers. USAC has overall responsibility for universal service programs, including the disbursement of high cost

payments to all eligible carriers. In managing its USF responsibilities, NECA employs multiple layers of review and data analysis. NECA's activity is further scrutinized by internal and external auditors annually, as well as by USAC and the FCC.

Current Universal Service Programs and their Impact on Rural Customers

All telecommunications carriers that provide interstate and international service pay contributions into the universal service fund. Telecommunications carriers can receive USF high cost support, if they meet state or FCC eligibility requirements, and provide supported services throughout the areas they serve.

There are seven components of the high cost universal service program, each designed to help recover costs of specific telephone services or infrastructure. There are also USF programs for low income Americans, rural health care providers and for schools and libraries.

For rural telephone companies, it's difficult to overstate the importance of universal service funding as one of the three essential revenue streams. Rural telephony is different. Let me give you a couple of examples of what it means to be a rural telephone company customer.

Here in Washington there are nearly 16,000 telephone lines per square mile. In the average rural area there are only 10.5 lines per square mile. In Montana, NECA member telephone companies average only 1.54 lines per square mile. One company in Texas has a customer density of 0.16 customers per square mile.

The companies serving in these places are typically small, some family or municipally owned, and some were started by farmers. These companies began springing up in the early part of the twentieth century – because the big phone companies didn't – and still don't – want to go to these very rural areas. In fact, today most of the large companies are more interested in selling off customers in rural areas than serving them.

Low customer density, of course, means fewer customers to absorb costs. Rural terrain, and distance between customers and telephone company central offices create unique challenges in deploying lines and telephone switching equipment. All of this translates to significantly higher costs-per-line than larger companies have.

If our companies had to pass on the real cost of basic service to their customers, a lot of those folks simply wouldn't have phone service because it would be too expensive. The universal service fund helps offset some of these higher costs. Without it, many customers of rural telephone companies could not afford to have basic telephone service.

I'm chairman of the board of NECA, but I also run a small telephone company in Minnesota, so I know what it would mean if universal service funding were to be eliminated or significantly changed. For example, Johnson Telephone Company in

northern Minnesota has about 2000 lines. If USF were eliminated tomorrow, customers of Johnson Telephone Company would pay about \$80 more per month for phone service.

Similarly, if intercarrier compensation isn't carefully managed or if it is eliminated, pressure will be put on the other two revenue streams – from customers and from USF.

So my message here today is, we need to look carefully at the total picture when considering the economics of providing service to rural telephone customers. Tinkering with any one of the three basic sources of revenue may significantly affect the others, and have negative impacts on rural customers.

NECA will be pleased to do what it can to help you understand these issues, especially as they relate to rural telephone customers.

Thank you.