



INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

March 26, 2010

Jonathan Adelstein, Administrator
Rural Utilities Service
United States Department of Agriculture
STOP 1590
1400 Independence Avenue, SW
Washington, DC 20250

Dear Mr. Adelstein:

The Independent Telephone & Telecommunications Alliance (ITTA) submits this request that the Rural Utilities Services (RUS) amend the Grant Agreement for Round 2 grants in the Broadband Initiatives Program (BIP). ITTA members are mid-size telephone carriers that collectively serve 24 million access lines across 44 states, offering their end-user customers high-quality wireline local and long-distance, wireless, broadband, video, and data services. ITTA commends the RUS to eliminate the restrictions set forth in Section 7.7 of the RUS Grant Agreement pertaining to Round 2 of the BIP in order to increase incentives for private investment in rural broadband.

The American Recovery and Reinvestment Act of 2009 set into motion a triumvirate of efforts intended to increase broadband deployment throughout the Nation. American Recovery and Reinvestment Act, Pub. L. No. 111-5, 123 Stat. 115, 42 U.S.C. sec. 6001(k)(1) (2009) (ARRA). The RUS Broadband Initiatives Program (BIP), NTIA Broadband Technology Opportunities Program (BTOP), and Federal Communications Commission National Broadband Plan (NBP) all recognize that comprehensive National broadband deployment will ultimately be driven by the partnership of private sector and public investment. Toward that end, ITTA has consistently advocated policies that increase incentives for private sector investment, since maximization of private sector investment lessens the impact of broadband deployment needs on Federal resources. Likewise, the NBP cites “private investment and market-driven innovation” as factors in broadband development over the past decade, and accordingly recommends “actions government should take to encourage *more private innovation and investment*.” NBP at 3, 5 (emphasis added). The RUS Grant Agreement pertaining to Round 2 of the BIP, however, imposes restrictions that will constrain applicants’ ability to secure private capital, leaving providers and Federal agencies with a Hobson-type choice of either discouraging additional rural broadband deployment or increasing Federal funding.

Section 7.7 of the RUS Grant Agreement restricts Grantees from making, without prior written approval from RUS, any type of profit allocations, including dividend payments. Specifically, Section 7.7 provides:

(a) The Grantee shall not, without prior written approval of RUS, make any membership withdrawals, unit distributions, or other types of profit allocations to its members, if it is a limited liability company, nor make any dividend, stock, capital, capital credit or other distribution in the nature of an investment guarantee, extension of credit, loan or advance payment of obligations if it is a corporation or cooperative (all such distributions hereinafter collectively called "Distributions"); provided however, the Grantee may make a Distribution after 75% of the Grant funds have been expended as approved if after such Distribution, the Grantee's Net worth is equal to at least twenty (20%) of its Total Assets and the amount of all such Distributions during the calendar year does not exceed twenty-five percent (25%) of the Grantee's Net Income or Net Margins for the prior calendar year.

(b) The Grantee shall comply with the additional negative restrictions on Distributions and Withdrawals set forth in Schedule 1.

ITTA commends the RUS to eliminate the restrictions set forth in Section 7.7. The restrictions will have a detrimental impact on providers' ability to obtain private capital, and conflict directly with the goal of "encourag[ing] more private innovation and investment." NBP at 5.

Dividends represent a cost of capital that is substantively similar to interest a borrower pays on a loan; it is the return on investment to the investor. Restrictions on dividend payments will reduce incentives for private investment in broadband networks, as investors will be bereft of opportunities to recover earnings on their investment.

The positive role of dividends has been recognized by the judiciary and industry analysts. The District of Columbia Circuit explained,

Each year that a durable utility asset is in use imposes on the utility the annual cost of the capital used for its construction (net of amounts already recovered in depreciation charges). In order to attract capital, a utility must offer a risk-adjusted expected rate of return sufficient to attract investors. This return to investors is the cost to the utility of raising capital. For the portion acquired through bonds, the cost is comparatively easy to compute – the interest the company must pay its bondholders. Common equity is more complicated, for equity investors do not have a legally fixed return. *Canadian Association of Petroleum Producers v. Federal Energy Regulatory Commission, Respondent, Inland Pacific Energy Services Corporation, et al.*, Case No. 96-1336 (D.C. Cir.) (2001).

Corporations have several ways of raising capital – bonds, stock, and borrowing. In any scenario, the corporation is obliged to pay for the use of capital, either through interest or dividends. Dividends are paid to holders of stocks with steady prices. Absent strong price appreciation, dividends enable corporations to retain investor capital, and the payment of dividends to shareholders compensates for generally lower gains in stock prices. The United States Supreme

Court explains the need for entities to maintain financial integrity, credit, and the ability to attract capital:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of business. These include service on debt and dividends on the stock (citations omitted). By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. *Northwestern Public Service Company v. Cities of Chamberlain, et al.*, 265 N.W.2d 867, 873, citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 US 591, 603, 64 S.Ct. 281, 288, 88 L.Ed. 333, 345.

The restrictions that Section 7.7 would impose will dangerously alter the ability of providers to attract private capital. In turn, providers and the government will confront the dilemma to either scale back broadband investment, to increase reliance on Federal funding mechanisms, or to increase end-user rates. End-users in rural and high-cost areas would most likely be hit hardest. Describing the unique predicament of rural end-users, a leading industry analyst explained, "Unlike investors, who can stay away from potentially unprofitable investments or can sell them, consumers often cannot easily move away from the high-cost areas in which they live." Telecom Regulatory Note, Regulatory Source Associates, LCC, Anna-Maria Kovacs (Nov. 6, 2008). Providers' ability to raise capital should not be restricted by programs intended to increase broadband deployment. ITTA is, in fact, aware of potential BIP applications that have not been filed since Section 7.7 was published. This result is antithetical to the intent of the broadband-oriented provisions of the ARRA.

Accordingly, for the reasons set forth herein, ITTA recommends that the restrictions set forth in Section 7.7 be removed in order to promote incentives for private investment in rural and high-cost areas and reduce pressure on Federal mechanisms.

Respectfully submitted,



Joshua Seidemann
Vice President, Regulator Affairs