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TO REVIEW THE UNITED STATES DEPARTMENT OF AGRICULTURE RURAL UTILITIES SERVICE BROADBAND PROGRAM

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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CONTENTS

Page

HEARING(S):

To Review the United States Department of Agriculture Rural Utilities Service Broadband Program 1

Wednesday, May 17, 2006

STATEMENTS PRESENTED BY SENATORS

Chambliss, Hon. Saxby, a U.S. Senator from Georgia, Chairman, Committee on Agriculture, Nutrition, and Forestry 1

WITNESSES

Panel I

Andrew, Jim, Administrator, Rural Utilities Service, United States Department of Agriculture, Washington, DC 3

Panel II

Pagon, Mark, Chief Executive Officer, Pegasus Communications, Bala Cynwyd, Pennsylvania 17

Sevier, Larry, General Manager and Chief Executive Officer, Rural Telephone Service, Lenora, Kansas 15

Simmons, Tom, Vice President for Public Policy, Midcontinent Communications, Sioux Falls, South Dakota 20

APPENDIX

PREPARED STATEMENTS:

Salazar, Hon. Ken (with attachment) 34

Andrew, Jim 37

Pagon, Mark 48

Sevier, Larry 52

Simmons, Tom 57

QUESTIONS AND ANSWERS SUBMITTED FOR THE RECORD:

Coleman, Hon. Norm 68

Grassley, Hon. Charles 69

Harkin, Hon. Tom 70

Linclon, Hon. Blanche L. 74

Salazar, Hon. Ken 75

Servier, Larry: .....

Written responses to questions from Hon. Tom Harkin and Hon. Ken Salazar 78

TO REVIEW THE UNITED STATES DEPARTMENT OF AGRICULTURE RURAL UTILITIES SERVICE BROADBAND PROGRAM

WEDNESDAY, MAY 17, 2006

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The Committee met, pursuant to notice, at 10:34 a.m., in Room SR–328A, Russell Senate Office Building, Hon. Saxby Chambliss, Chairman, presiding.

Present: Senators Chambliss, Coleman, Harkin, Lincoln, Salazar, and Dayton.

OPENING STATEMENT OF HON. SAXBY CHAMBLISS, A U.S. SENATOR FROM GEORGIA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Chairman CHAMBLISS. The Committee will come to order, and I welcome you to this hearing to review the United States Department of Agriculture Rural Utilities Service Broadband Program.

I appreciate our witnesses and members of the public being here to review this very important topic as well as those who are listening through our Website. Over 3 years ago, President Bush set forth an ambitious goal of universal, affordable access to broadband technology by 2007. While bold, the goal is necessary, and universality is fast becoming a key objective to ensure that geography does not become a barrier to entry into the information economy.

Agriculture has always been at the forefront in the adoption of new technologies. In the 20th Century, tractors, combines, hybrid seed, and new tillage methods defined improvements in yield, quality, and efficiency. The innovations of the past are fast being eclipsed by those of the future, with biotechnology and information services helping to define how farmers and ranchers will be profitable.

While the agriculture sector is an important constituent, rural America also includes small businesses, local governments, health care providers, first responders, and residents in our communities. All of these stakeholders have a strong demand for broadband access, and it is already clear to policymakers in the United States and around the world that broadband access can help facilitate economic development and civic participation.

The success of the Rural Electrification and Telephone programs over the past 70 years demonstrates the long-term impact of extending utilities that were once thought to be too expensive for

rural Americans. The Tennessee Valley Authority is a good example of the impact that extending utility service can have on a single State and region. These experiences are helping foster a new debate: how the Federal, State, and local governments can help rural America bridge the digital divide.

Data from the Pew Internet and American Life Project indicate that the broadband gap between rural and non-rural Americans at work is small, but gaps persist at home. While rural areas lag their urban counterparts in access, deployment of broadband presents different challenges and obstacles compared to traditional utilities services.

To help bridge this divide, the 2002 Farm Bill authorized a loan and loan guarantee program to help ensure that rural consumers benefit from the same quality and range of telecommunications services that are available in urban and suburban communities. Complementing the loan program, the Rural Utilities Service manages the Community Connect Grant Program targeting broadband services to schools, libraries, education centers, law enforcement, and other customers in rural areas.

These two programs are part of an overall national effort to help promote connectivity and rollout of the broadband access. However, as with any new technology or service, there will be occasional problems with its application and program management. The Broadband Program has been the subject of two recent reports from the Government Accountability Office and the Department of Agriculture's Office of Inspector General.

The purpose of this hearing is to engage the Department and key stakeholders in a dialog. I am eager to listen to how the program is working and what improvements have been made to the management structure since the start of Administrator Andrew's tenure. This is a good opportunity to hear what recommendations were made in both reports, which ones are being implemented, and how problems in the beginning years of implementation can be avoided in the future.

These lessons will be critical as we move into reauthorization of the Farm Bill next year. We need to recognize that the Broadband Program is just one part of a more complex puzzle on promoting the deployment of equipment and facilities. New technologies like satellite and wireless systems are redefining how high speed access is delivered to homes and businesses across the country. It is important to note that other Federal agencies like the Department of Commerce and the Federal Communications Commission are key actors in this issue.

Together, we can successfully reach the President's goal of universal access, and I look forward to working with my colleagues in the Senate to help make this a reality. When my colleague, Senator Harkin, arrives, we will obviously be happy to have him make any opening comments he wishes to make. We are going to have two panels today. The first panel is Mr. Jim Andrew, Administrator, Rural Utilities Service, U.S. Department of Agriculture here in Washington. Jim has been a long-time personal friend of mine. He and I have come up through the electric cooperative business together. He is the right man at the right time for the RUS position,

and I'm very pleased to have Jim in that position and obviously very pleased to have you here this morning.

Our second panel is Mr. Larry Sevier, General Manager and Chief Executive Officer, Rural Telephone Service, Lenore, Kansas; Mr. Mark Pagon, Chief Executive Officer, Pegasus Communications, Bala Cynwyd, Pennsylvania; and Mr. Tom Simmons, Vice President for Public Policy, Mid Continent Communications, Sioux Falls, South Dakota.

Jim, we look forward to any opening comments you wish to make and to a discussion on this issue.

Welcome.

STATEMENT OF JIM ANDREW, ADMINISTRATOR, RURAL UTILITIES SERVICE, U.S. DEPARTMENT OF AGRICULTURE

Mr. ANDREW. Thank you, Senator Chambliss.

Since being confirmed and sworn into office, this is my first opportunity to offer testimony before you, and I appreciate the time. As this is the first time to be with you since my confirmation, I wish again to express my appreciation for the courteous and speedy manner in which I was confirmed. Then, to be sworn in soon after allowed me to get on with the work at hand.

During that confirmation hearing, the prevailing theme was broadband to rural areas of America. Community members expressed great interest and desire to see the deployment of this high speed connectivity. I, too, expressed my conviction that broadband might well be the next railroad or high speed highway that could connect rural areas with the commerce of the rest of the Nation and the world.

Without it, some of our rural communities might very well not survive or at the least not realize the prosperity that can be derived from such connections. At that time, I also even shared the frustration I and my wife feel when trying to get into the Web from our home in rural Georgia.

The conclusion of that day was the desire issued by the Committee and accepted by me to improve and speed the deployment of the Broadband Program as assigned to the Rural Utilities Service. I and the broadband staff at RUS are working very hard toward satisfying that desire.

It must be noted that RUS is responsible for the Rural Electric Program the Rural Telephone Program, and the Water and Waste program. I will tell you, however, that over 50 percent of my time is spent on the Broadband Program. With that in mind, to say that the Broadband Program is a challenge is an understatement. The Rural Electric Program has over 70 years of experience in the development of that program. In that time, a track has been laid that is easy to follow with basically the same participants, with the same needs year after year. Rural Telephone and Water and Waste have the same history.

Broadband, on the other hand, does not have the benefit of that history. Every application is new in terms of the applicants, the business plans, the financing arrangements, which I must add are sometimes very creative, the locations, the technology, the scope of their plan, the time to deploy, the area to be served, and the surveys projecting service already in place.

Each of these factors are being considered as we continue to develop better ways to analyze the ever- changing and different applications. The key word there is continuing. Shortly after my swearing in, we had a meeting of a large group of staff that had extensive knowledge of the RUS programs and how they were managed. We identified the areas of the Broadband Program that we felt needed improvement and in order to be effective in the deployment.

With that information, the process of refinement began with a smaller group of staff with skill sets needed to develop a product that could be implemented. There were legal, technical, business, and policy members of that committee. The main issues needing refinement were more precise definition of rural, consideration of credit support requirements, speeds to be provided in the application offerings, and the time to deploy.

Each time we thought we had an agreement on the issue, a new question would be raised, either by a new application or some further research by the committee members or the industry. An example of industry input is the suggestion from the Cable Association that pointed out that our announcement in the newspapers was not sufficient notification that one of our applicants intended to deploy in a particular area. We accepted their suggestion to post the announcement on our Webpage. Further, at their suggestion, and with a visit to and the consent of the Chairman of the FCC, a link to their site will be sent interested parties to an announcement on our site.

This is why I describe the process as continuing. The product is almost to the point of being rolled out once cleared. To say that it is the final word on broadband as pertains to the mission of RUS would be a mistake. As applicants change, as technology changes, as needed information from the Web changes, as the need for rural constituents change, so must we adapt. I've compared it to hauling a load of frogs in a wheelbarrow: we must stop from time to time and adjust our load.

With that picture in your mind, I also want you to know we have a plaque in the office that states: the answer is yes, somehow. In summary, we at RUS believe in the value of broadband to rural America and are working hard to do our part in this deployment. We believe our work is vital to the economic development of rural America. We believe that the loans made are investments in that economic development.

A deployment in Iowa or Colorado that creates economic growth also benefits taxpayers in Georgia and the rest of America. I have opportunities to speak to groups around the country, and I begin each presentation with I am from the Government, and I am here to help you. It always creates smiles, but I firmly believe it is our mission and our driving force. Thank you again, Senator, for your time, and that concludes my opening remarks.

[The prepared statement of Mr. Andrew can be found on page 37 in the appendix.]

Chairman CHAMBLISS. Well, thank you, and as I mentioned in my opening statement, USDA's Office of Inspector General released a report critical of the program management. Namely, OIG states that RUS has shifted the program's focus away from those rural communities that would not, without assistance, have access to

broadband technologies. Can you address this core critique and explain what specific steps your agency has taken to address this concern since you've been there?

Mr. ANDREW. Yes, Senator; excuse me. In the IG report, it refers to some communities that are rather large and some applications we had in house that served some areas that met the original criteria of 20,000 population or less and that was basically underserved. It also mentioned one that was in Los Angeles County, California, which we did turn down and was not approved.

In my statement, I've made the comment that we have had some—we have appointed a group of people who have been studying this issue, and one of the issues has to do with the final definition of what rural actually is. Senator just for your information, one of the applications we had listed Snellville, Georgia. Now, you know, Snellville sounds like a rural community, but it's a suburb of Atlanta, and it met all of the qualifications. But it was turned down. So we have been doing that, and we are now working to better define what rural areas really are.

Chairman CHAMBLISS. Very good. One of the better known critiques of the OIG report is the finding that suburban developments receive loans, and your example of Snellville is a good example of that. As you know, most suburbs of our major metropolitan centers were at one time either farmland or pasture. Suburban and urban encroachment constantly redefines if a community is rural or rapidly developing. Can you describe how RUS manages this reality, and how do we make sure that the program resources are efficiently and optimally targeted to those communities most in need?

Mr. ANDREW. Yes, as I pointed out, we are trying to really define what rural means. As you restated, Snellville was listed, and I might tell you that Fairfax County, Virginia, was one that was listed once as being a qualified applicant, because it had cities and towns of less than 20,000. You're right; the urban centers have grown out there. Now, in our case, for example, in my case, Millen, Georgia, is listed as an urban cluster. So how do we describe that based on the census report? We are working very hard to arrive at a conclusion of what urban really is and how we are going to serve that area.

Chairman CHAMBLISS. Managing risk is perhaps one of the most difficult issues to deal with in a loan program. The higher the risks taken on by a lender, the more likely the default risk will increase. Lowering the risk in areas that don't have ready access to private capital will not be helped much by a lender of last resort like the Federal Government. Can you explain how RUS determines the level of risk it will manage, and what are the specific tradeoffs you have seen in the management of the Broadband Program? Also, what are the dangers of increasing the risk level in the lending program in terms of long-term viability?

Mr. ANDREW. As you pointed out, this was designed for economic development to help rural areas of America, and we consider that when we look at the risks. For example, we require a credit support of 20 percent at this point. We're considering that right now. But if someone has interest in the program and has some skin in the game, so to speak, we think if their application has a business plan that will meet our requirements, we are willing to accept that

risk if he is willing to accept that risk. Now, we still continue to keep the vision in mind that we are supposed to be developing rural America. That is what a risk we are willing to take.

Chairman CHAMBLISS. In a change from the infrastructure program, the Broadband Program now allows for loans to entities that are competing with existing service. This has been one of the program's most controversial provisions. How will RUS respond to an entity default on an RUS loan due to a competitive loan through the Broadband Program, should this aspect of the loan program continue, and does RUS plan to focus or refocus future loans on areas that do not already have existing service?

Mr. ANDREW. Senator, you mentioned infrastructure. Are you talking about a telecom infrastructure now, or are you just talking about general applications?

Chairman CHAMBLISS. Telecommunications infrastructure.

Mr. ANDREW. Infrastructure. First of all, the infrastructure, when this program came out, they were all offered the opportunity to get into broadband. They were offered that opportunity before we ever got started. If it was never offered by the infrastructure organizations, then, we would go in there. Now, the question was if they default on their loan, I am not sure that having broadband in there was the reason for the default.

I will tell you, Senator, that in visiting with some of these infrastructure organizations, we are finding that they are losing some of their load, some of their members because of cell phones. But we are encouraging them to get into the broadband business. We are encouraging them to expand their offerings, and if they have not, it was offered to them. Now, what we would do about that is we would continue to offer this service in those areas.

Chairman CHAMBLISS. The formal title of the program is the Rural Broadband Access Loan and Loan Guarantee Program. What has been the agency's experience with the loan guarantee side of the program, and has RUS worked with telecommunications sector lenders to garner interest in this provision?

Mr. ANDREW. We have no applications for loan guarantees. We would like very much to have them, Senator, but the application is an 80–20 loan, and the private sector lending agencies are not interested in getting into this business. But we very much would like to have it, because it eases our job in that they would do the back office work; they would do the testing of the loan, and we would very much like to do it, and we are still encouraging it. We would like to still have it in the program.

Chairman CHAMBLISS. I hope we can really give some emphasis to this, Jim, because history has shown that the Federal Government's involvement in the lending business is not in the best long-term interest of the taxpayers. We do much better when we work hand-in-hand with the private sector allowing the private sector to do the making of the loan and allowing us to guarantee it when they think it's appropriate for us to do so. I really do hope you will give some strong emphasis to this guarantee section in appropriate legislation.

Mr. ANDREW. As I understand it, when this program was started up, it was recommended that there be an 80–20, meaning 80 percent private sector and 20 percent guarantees. Of course, that

would not do anything for the deployment of this business. But we are having a hard time finding private sector lenders who will participate in these loans. We very much would like to have it that way; very much would like to have it that way.

Chairman CHAMBLISS. And perhaps it should be—we should look at that as we move into the Farm Bill. Instead of 20–80, perhaps it should be 80–20, which is the case in most of our guarantee programs.

Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman. Thank you, Administrator Andrew. We appreciate your being here and to help provide our Members of the Committee with an update on your effort to manage what I and I know others really recognize a as a very complex but extremely important set of programs that help provide many of our rural areas the tools they need to compete in a global economy.

I grew up in rural America in a seventh-generation Arkansas farm family, and rural America is still my home, and it's so important that they don't get left out, and I think that these are some critical issues that allow them to participate. I was home in Arkansas, oh, a couple of weeks ago, and I ran into a gentleman who had bought a considerable amount of real estate in one of our smaller communities and restored these old structures and was helping the town capitalize on some of its tourism.

And he had purchased his first property back in 1996, but he owned businesses that were located in Annapolis and San Francisco and I think Chicago. He said we're finally able to move here in 1999, when we were able to get the kind of connections to the rest of the world that we needed to enjoy living in rural America but running our businesses in a global sense. That's what this is about is returning the capacity to Americans to live in a quality of life that they know and enjoy and want to but to still be able to participate in the global economy. I think we all agree that expanded deployment of broadband technology across the country and especially in our currently underserved areas is key to our nation's overall ability to compete in the digital age.

So the ways that we can improve the quality of life and opportunity in some of our more economically distressed parts of the country is a critical issue for me and many other members, I know, and we appreciate your efforts in, as I said, trying to implement what is a very complicated set of programs. We want to work with you and Members of the Committee to ensure that the USDA's Broadband Program functions efficiently and effectively for rural America, and I think there are a couple of interconnecting programs that are important in order to be able to utilize what you try to do.

And I have got a couple of questions, Mr. Chairman. Particularly interested in the Community Connect Grant Program. We have a special projects team on our staff in the State, and they have been looking at the scoring criteria for this program, where it gives the maximum points of 40 to a community with a population of 499, and by the time you reach a community with a population of 2,000 to 3,000, the score is only 20, which makes it really difficult for a community of that size to compete, which they are the more likely,

actually, community at that point to compete. I guess given that fact that many of our tiniest of communities with populations under 499 often lack the capacity to maintain the program once it is installed, in your opinion or your viewpoint, would it make sense to reevaluate the scoring criteria to allow those slightly larger communities but still very much rural, small communities and isolated in many instances to be more competitive?

Mr. ANDREW. I thank you for that, Senator, and that's not been in our discussions, but we will certainly add that, because that's certainly a criteria we ought to look at, and I appreciate that, and we will.

Senator LINCOLN. Well, I hope that you will.

Mr. ANDREW. Yes, we will.

Senator LINCOLN. Because I think that in terms of the viability and the sustainability, looking at the size of the community and the way that the scoring is attributed to those communities would be helpful in reflecting some success in the program.

Mr. ANDREW. It is a good program.

Senator LINCOLN. So if we need to follow up with you on any of that, or if you've got ideas, I hope you'll——

Mr. ANDREW. We are making a note right now.

Senator LINCOLN. Great. I hope you will stay in contact with us.

The last question I have, Mr. Chairman, is your interpretation of how important other programs are to the sustainability of what you do with your program. I know for us, health care and telemedicine are critical, but much of the resources dedicated to programs like AHEC and the outreach programs, health care initiatives, particularly preventive care in our smaller communities have been zeroed out, along with some of the I guess debate as to how important the Universal Service Fund is, which allows much of our smaller telecommunications companies to operate.

Do those types of programs have—what kind of a direct relationship or indirect relationship do they have to the success of your program?

Mr. ANDREW. You are speaking of health care?

Senator LINCOLN. Well, the telemedicine and the AHEC, which is the Area Health Education that's run mostly through the medical schools, and its outreach into the small rural areas, and they use a lot of telemedicine through those programs, connecting, you know, medical schools and larger city hospitals and doctors with the smaller communities and then, also, the Universal Service Fund, as we all know, which allows smaller telecommunications that operate in rural areas to serve their constituency.

Mr. ANDREW. Well, I have the experience, Senator, of twice being able, in the short time I've been there, twice being able to go and present checks, awards, to hospitals. I've been completely awed by what they're doing with it. I mean, we know of one case in Pennsylvania I went to that have got people online at home, where the doctors, the nurses are able to monitor their progress. It cut their recidivism back into the hospital from about 70 percent down to about 20 percent.

Senator LINCOLN. Right.

Mr. ANDREW. And is saving the hospital over $500,000 a year. So we are extremely interested in that. We promote that rather heav-

ily, because we do see what it is doing. Now, I am not sure I have answered your question entirely, but telemedicine and also, I might say, distance learning——

Senator LINCOLN. Right.

Mr. ANDREW [continuing]. Has been a real critical thing with this, too. You know, I think we've done a real good job with that.

Senator LINCOLN. Well, we know, you know, and again, the efforts that you've made and these programs, the importance of them. I guess my question is really how they dovetail with other programs and how those other programs and resources actually support the overall sustainability of what you are initiating or what you are doing through both Universal Service Funds, AHEC programs, and other types of health care outreach for rural areas. So we will look at that and might send you a question there that you can kind of expand on, if you'd like to, at a later date.

Mr. ANDREW. I would be glad to do that, and I think it's something I should answer, and I will.

Senator LINCOLN. Great, thank you, Mr. Andrew.

Thank you, Mr. Chairman.

Chairman CHAMBLISS. Senator Harkin.

Senator HARKIN. Thank you very much, Mr. Chairman. I apologize for being late. I had a previous longstanding engagement I had to attend to off the Hill.

But, Mr. Chairman, let me thank you for calling this hearing. Broadband Internet access is crucial for the success of our rural communities. I keep saying my hometown, we still do not have broadband, and a lot of rural communities do not. I remember, Mr. Andrew, when you appeared here before us earlier, we talked about this. So, I'm delighted to see you here. I hope that after half a year in Washington that you will see our approval of your nomination as a blessing and not a curse after being here for half a year.

Mr. ANDREW. No comment.

[Laughter.]

Senator HARKIN. You are all right.

[Laughter.]

Senator HARKIN. Well, there have been some signs of some broadband access around. The GAO issued a report on this earlier; maybe someone talked about that. They said that while 29 percent of urban households and 28 percent of suburban had Internet, only 19 percent in rural America, and that is a big gap. The problem that we see in Iowa, while they say that 95 percent of our communities have access, what happens is a town will have access in a small pocket, but the rest of the town will not have access. That's the big problem. So, it's not really universal access. They say 95 percent have access. Well, that means a small town downtown area might have access but not out to the houses and stuff like that that's in the community.

The loan program that we put in the Farm Bill has not been carried out as it was written and intended. Broadband loan applications are rejected out of sort of a we don't want to have any risk at all. Well, that is why we have the program. You know, if you are just going to avoid the risk, well, if we were just going to avoid risk, we never would have had the Rural Electrification Corporation, either. So what RUS, I would hope that what the legislation

would do would be to work with borrowers to manage risk, to minimize losses.

And I think RUS set an inflexible 20 percent cash on hand rule that ignores future recurring income from subscribers. I've had instances of my own where they may not have had the 20 percent cash on hand, but they had enough subscribers that they could show on a business plan that they would be able to handle the cash-flow and the payment requirements. But they had to have 20 percent on hand, and they did not have it. So I think that is just way too inflexible, and I think that has had a chilling aspect on this.

So again, I know you have been there a short time. I know from having spoken with you before that you are a proponent of this. Again, I am sorry I am late. I just am interested in hearing again from you, Mr. Andrew, just what steps in the short time you have been there have you taken? And what are you doing right now to get over some of these hurdles? Just address the 20 percent rule, if you could. Is there any way we can get around that, or do we have to change it legislatively?

Mr. ANDREW. In my opening statement, Senator, I made the comment that we formed a committee made up of some legal people, policy people, technical people on our staff who have got a lot of experience in all of these RUS programs. That is under consideration. We have discussed it at length, and it is under consideration, and we are going to be writing the proposals of how it would be considered, whether it is less than 20, how much less than 20. If the business plan should call for more than that, would the plan have access to—be able to increase it or decrease it?

So, yes, Senator, we are working with that, because you're not the only one. We have heard it from other places.

Senator HARKIN. Well, I am sure you have.

But, see, time really is of the essence here.

Mr. ANDREW. We know that.

Senator HARKIN. Because by September, you know what happens to that money if it's not obligated. I do not know how much it is right now, around $900 million that we have on hand for loan capacity, my staff tells me on this. I don't know it particularly, but that would be a shame to lose this, because we are tied up trying to get through some of these onerous rules and regulations. So I hope you can assure us that you recognize that time is of the essence and we have to move on this expeditiously.

The other thing, Mr. Andrew, is that there are a lot of companies out there, and again, I know just a few of them; I'm sure it's true in every other rural State represented here, where they applied for these, were turned down for one reason or another, and yet, if they were to get these loans could immediately begin to put broadband lines in communities that have access but to get the lines out to the rest of the community. Do you know what I'm saying?

Mr. ANDREW. Yes, sir.

Senator HARKIN. I think a lot of times, RUS has looked at how do we just get it to a community? Well, if a community has access, then, they don't consider it. It should be considered if the community just has access but not the entire community, if you know what I mean, has access.

Mr. ANDREW. Yes.

Senator HARKIN. So I am hopeful that if you get through this, if you can get these rules changed, can you go back and look at those that were turned down to see if they are still willing and able to partake of this program? I would think that might be one of the fastest ways of getting that money out before September 30th.

Mr. ANDREW. Well, that is an interesting concept. The answer, I guess, somehow. As I pointed out earlier, we've got the answer is yes, somehow. I would think that they would have to reapply, obviously, but we could do that. We could take the applications and consider it on its merits; be sure nothing has changed in the community since that time also. We need to do that.

Senator HARKIN. I think this change has been made, but I cannot specifically say so. But both Senator Grassley and I had a small company in Iowa that we knew about—we did not own it; we knew about this company; we worked together on it where they happened to be owned by a woman. She had dealings with other communities, and I think she had, like, maybe—I'm pulling it out of my head here—I think maybe eight different communities that she could serve with her business.

But the paperwork was such that every community she had to serve, she had to have a full application for each one. Yet, it was the same company. These were all communities within a small radius of one another, and yet, she had to fill out hundreds and hundreds of pages of application, because each community required it rather than just saying, well, you're one company; you're going out there; just fill out one application for all the communities. I do not know if that has been taken care of, but I wish you'd look at that for me.

Mr. ANDREW. We will, Senator.

Senator HARKIN. Thank you very much, Mr. Chairman.

Chairman CHAMBLISS. Senator Salazar.

Senator SALAZAR. Thank you very much, Chairman Chambliss and Ranking Member Harkin, for holding this hearing, and Administrator Andrew, thank you for being here today as well. I have a more formal opening statement that I will submit for the record, but I will just make this comment and then have a couple of questions.

It seems to me, Mr. Chairman, and to my colleagues on this Committee, that as we move forward and try to figure out how we deal with the revitalization of rural America that there are two things that perhaps are going to be the most significant opportunities that we face in our country today. One of those is renewable energy, and we have had a hearing in this Committee, and I know many of us are working on the renewable energy opportunities for rural America.

I think the second will be the opportunities that come along with making sure that we move forward with the full advancement, as we can, of broadband out into rural America. I have been impressed in my own State that in places that I have gone, we have seen tele-health now coming out, available out in the rural parts of Colorado, and yet, there are many places out in the Eastern plains, on the Western Slope of my State where we do not have that kind of capacity available.

And I guess I would ask, following up on the questions of some of my colleagues, Administrator Andrew, this question: you know, given the disparity that we have between the availability of broadband in the urban areas, suburban areas versus rural areas, what would be the two most important things that you would think we could do as a Senate to try to further penetrate the rural broadband availability out into the rural areas? What would be the one or two things that you would say would be the most important things that we could do to help you get the job done on the vision that I know you share with us?

Mr. ANDREW. Well, I do share that vision, and if I might say so, Senator, I know there has been a lot of deployment of fiber optics in your State. I know of a couple of electric co-ops that did it, and you wrote me a letter concerning can we deploy fiber optics on the transmission lines, which we can and so forth, and I have studied your State well quite a bit.

The one thing I think is just stay with us, because we're working on it, and I believe we are going to be able to have a program soon that will be able to be able to answer some of these questions. Now, I will tell you this: when I had this hearing, I was up, commented to Senator Harkin, I, myself live so far in the country, the gentleman back here says you have to go back toward town to go hunting, and I do. I live 14 miles from the nearest town, and I am not sure how anybody can rationalize running a cable out there to me or running any other service other than maybe satellite, which is there now.

So we are working on that, trying to figure out who will be the players, how they're going to fit together, how they're going to do—what position they are going to take in this, and we are getting very close, real close, to having a product that we can announce to you that, as I pointed out in my earlier statement, every time we think we've got it, something changes a little bit to make us come back and regroup again.

But we're working very hard toward correcting anything that needs to be done that we have learned. We have learned some lessons over the last several years. But since December, we've been working very hard, trying to arrive at a conclusion as to what to do next. Now, directly answering your question, just stick with us. I think we'll come up with something that will be satisfactory.

Senator SALAZAR. Let me ask you just a question regarding your place 14 miles out in a very isolated area. You know, our family farm is in a similar situation, and I think broadband has come maybe within a couple of miles of our farm house, but it is not out there.

In terms of your exploration through RUS of alternative ways of getting high speed Internet out into some of these communities, what kinds of services is it that RUS is sponsoring and promoting to get to places like your place, so that even a place that is so far out in the back woods is going to have access to this new technology?

Mr. ANDREW. I did not say backwards, Senator, but anyway——

[Laughter.]

Senator SALAZAR. Back woods, not backwards.

[Laughter.]

Senator SALAZAR. I would never call anybody from the back woods backwards.

[Laughter.]

Mr. ANDREW. Our program is technology-neutral. Every day, somebody is walking into my office. Once a week, somebody walks into my office with a new idea about technology, how to deliver. We are looking at all of it; and we are neutral. We do have some concerns about some of them, however. You know yourself that when you got your first computer in about a year's time, it was obsolete. We are concerned about some of these——deploy some of these things, how secure our loan is going to be, but we don't need to worry about that. We need to worry about getting it out.

Senator Harkin was talking about in Iowa; I know that at least I have studied about something in Iowa. I believe most of the farmers, not most but many live in town and have their farms out in the country so that they could receive broadband in town. In our case, we live in the country. We live out on the farm. So it's a different story for us. In my case, I think right now, we could get it. We can get it with satellite.

There are some proposals, and we've got some applications in-house right now that would start with either a fiber in town or a Wi-Max, as it is called, that will hit the perimeter of the town and reach out as far as 18, 20, maybe 30 miles, depending on the terrain.

So it will be like a rock in a pond. It will start to expand and grow. As the technology comes along, as the technology gets better, I think that wave will get broader and broader. I hope it will; that's what I'm counting on anyway, sir.

Senator SALAZAR. Well, I sure hope that we see broadband out in your place.

One final question if I may, Mr. Chairman, and that is with respect to the $900 million or so that currently still is available for lending, if you look at the timeframe that we have ahead of us, and this was clear; I think it's an additional four or 5 months, what is the plan that you have in terms of at least making that, the information of the availability available out there to applicants?

Mr. ANDREW. We have in house, if you will excuse me 1 minute, right now, we have applications approaching $800 million, so we are getting close to that now. We've got several applications in house that we're working now. That will take up—if we can get it done in time, and we are working very hard to get these applications completed and the money deployed. So we are working toward it. We're getting there.

Senator SALAZAR. Thank you very much.

Mr. ANDREW. Thank you, sir.

Chairman CHAMBLISS. Senator Coleman.

Senator COLEMAN. Thank you, Mr. Chairman, and thank you for this hearing. I have a great passion about rural infrastructure, and infrastructure is not only wastewater, but these are the roads and highways of the future. Administrator Andrew says it well in his testimony: with the correct technology and connectivity, you can do business anywhere in the world, and you can live anywhere in the world. I've been on Minnesota farms and been impressed with the

technology; I've been in small towns and seen how technology can move us forward, but we need help, and we have some challenges.

But one concern that I have is government cannot do this by ourselves. We are not the only game in town, and in fact, you know, there are folks out there making investment and trying to bring technology to rural communities. My concern is about that playing field, Mr. ANDREW. One of the witnesses who will testify later has raised two concerns that I wanted to run by you. One is this issue of whether we should be providing support in areas where there is already existing broadband service. As I understand the mission, it's to go to those places that are not served. But that does not always appear to be the case. Can you respond to that, I mean, how you look at that and how you factor in whether, in fact, service is already there and how that impacts a loan application?

Let me give you both, in fact, because they're really tied together. The other issue, then, is, and I presume in order to get some of that information, you would want to check to see who's already out there, who's serving, what's going on there? The other concern that a later witness will add, it really has to do with transparency in the process. The concern is, and I will just kind of——this is from testimony that will come later—but I want to lay it in front of you now so that I can get a response. The RUS does not disclose when an application has been filed, the name of the applicant, the communities the specific applicant proposes to serve, or the assertions made about existing broadband service in a community.

It does provide an update on online lists of towns and unincorporated rural areas in a State that are covered by a pending approved application, but there is, however no true public notice and comment period that ensures the public is heard prior to a loan being granted. I will just read one more sentence. In fact, the only way an applicant can find out, the only way anyone can find out how an applicant is characterizing a market is through a Freedom of Information request, and to the best of our knowledge, such requests are usually fulfilled after the application is approved.

So can you talk to me a little bit about the transparency issue in the process and what efforts we make to kind of work in partnership with the private sector, so sort of being filled, we'll kind of focus on those places that don't have service?

Mr. ANDREW. Let me ask you the second one first. I am aware of who that is. We invited them to come into our office and discuss these very issues. We have already taken one of their suggestions, which I mentioned in my opening remarks, that our announcement as to the towns that are going to be covered was not an adequate announcement.

And we agreed with that, and we are going to post this on our Website, and we have also worked with the Chairman of the FCC, and he has agreed to let us post a link on their Website over to ours, because the suggestion was that a lot of these people come in and check the FCC Website every day, but they do not check the local newspaper, because that's where we advertise and where we're required to advertise is the legal section of the local newspaper. So that was one step, and we are going to do that.

Now, as to the other step, when an application comes in, the person has to present a business plan: let's make this thing pay. If

they come in, and they say they can get a certain percentage, they have to conduct a survey. If the survey says that they can do a certain percentage of take if they go into that town, even though there are other providers there, if that take will cash-flow and make a business plan work, then, we will make the loan there.

Now, what does that do? It just offers more to other people. We are not trying to run other people out of business. We'd like them to increase their services. But if a person can show in their application that they can take enough to make their business plan work, we will consider their application, and all things being equal, then, they will be awarded.

Senator COLEMAN. OK; well, Mr. Chairman, I am a huge fan of this program, and I appreciate the great leadership, Mr. Andrew, that you are providing. My concern is that we take advantage. A public-private partnership is a good thing. I learned that as a mayor. I think there are some opportunities here. We have limited resources. We have communities that have great needs that aren't being served, and I would hope that would be a first priority.

And in those areas where there is—competition is a good thing, but I would hope that first and foremost, the priority would be go to those places that for whatever reason, the economics are not there, but the need is there for folks who live 14 miles from the nearest town.

So I appreciate what you're doing, and I appreciate the opportunity that some of my constituents have had to have these conversations and your responsiveness. Thank you.

Mr. ANDREW. Thank you, Senator.

Chairman CHAMBLISS. OK; Mr. Andrew, thanks very much for being here today. We are very much appreciative of your testimony and the work you're doing. There will be some additional questions maybe that will be submitted to you in writing, and we will get those, and I hope you'll respond to those very quickly, please.

Mr. ANDREW. Thank you, Mr. Chairman, Senators.

Chairman CHAMBLISS. Thank you very much.

Chairman CHAMBLISS. Our second panel, Mr. Sevier, Mr. Pagon, Mr. Simmons, if you will come forward, please.

Gentlemen, again, welcome, and thank you for taking time to be here this morning. We look forward to your opening comments. Mr. Sevier, we'll start with you; Mr. Pagon; then, Mr. Simmons. Welcome.

STATEMENT OF LARRY SEVIER, GENERAL MANAGER AND CHIEF EXECUTIVE OFFICER, RURAL TELEPHONE SERVICE, LENORE, KANSAS

Mr. SEVIER. Thank you, Senator. My name is Larry Sevier. I'm the CEO and General Manager of Rural Telephone Service Company and our subsidiary, Nex-Tech. We live in the remote regions of Northwest Kansas. We provide voice, video, and data services to 10,000 customers, spanning over 5,000 square miles. So you can see that the density is rather small, at two per square mile.

We've been using the traditional RUS loan program for over 50 years to bring the traditional triple-play services, voice, video, and data to our service area, and we began providing the high speed Internet service in 1998. We have done it through a variety of tech-

nologies. We've used DSL; we've used fiber to the home; and we're also using wireless. Currently, we provide telephony services and high speed Internet service to over 85 percent of our service area, and we continue to push fiber further out into the remote rural areas every year, so that we are hoping we will get 100 percent out in the next five to 10 years.

Our penetration rate for high speed is very high in our traditional service area, where we're providing the fiber. It's over 40 percent per household for the high speed. The remainder of the service area, we are handling with satellite service through NRTCA with a service called Wild Blue.

Until recently, many of the neighboring communities served by the larger companies were without broadband service or perhaps inadequate broadband service, and obviously, this stifled economic development in Western Kansas. Seeing the need and the despair of the neighboring communities, Rural Telephone wanted to help bring economic stability to Western Kansas. We could do so through our deregulated subsidiary Nex-Tech if we could find the funding. Funding is not adequately available through the local sources, and some other funding streams dried up as well.

When we learned about the pilot program through RUS, we immediately applied for a loan for two of the communities in northwest Kansas, Norton and Almena. We received a $6 million loan to bring broadband service to these communities. They're not large communities. Norton is 3,000, and Almena is only 500.

So with the funding of the RUS Broadband Program, we brought fiber to the home to these communities. We held community events, we went door-to-door, we had sign-up events prior to actually starting construction and signed up 70 percent to telephony services prior to construction, and 25 percent signed up for the high speed Internet service. Today, we have a 96 percent take rate for telephony services in those communities and a 50 percent take rate for the high speed. I know the local newspaper editor said that was one of the biggest events that he had seen in Norton in quite some time, so it showed that the need was there, and the people were hungry for broadband services. I think this illustrates the good purpose of the RUS Broadband Program.

Nex-Tech has since received three additional loans for over $15 million to bring broadband service to five additional communities in Western Kansas, and the population is 1,500 to 2,700 in these communities as well. We have a penetration rate of over 80 percent and a 47 percent broadband penetration rate in those communities today.

Through the National Rural Telecommunications Cooperative, Nex-Tech has also used a satellite program, Wild Blue. While it is a good program to reach the last mile of customers, the price and speed limitations do make a difference on the penetration rates, and so, our rates there are not as high, but I would quickly add that the service has been a very useful tool to reach the areas that we cannot reach with a traditional program.

Rural Telephone is currently in the process of acquiring 12 Sprint exchanges in Western Kansas. Some of these communities still do not have Internet service, and other areas have very limited service. Rural Telephone will be utilizing the traditional RUS pro-

gram for the acquisition and the rebuild of these communities with fiber to the home.

We look forward to closing on this transaction and providing high speed Internet service to these communities to help stabilize the area even further. We are passionate about these areas because we live and work there. These are our neighbors. Our young families are moving back into the areas of Western Kansas. We have provided at least 300 jobs internally with Rural Telephone and NexTech over the last few years, and hundreds of other jobs have been created, as small businesses move back into Western Kansas, and so, we think we have stabilized the economy through the RUS broadband program.

I see I am running out of time. Do you want me to continue? I've got just a few more comments.

Chairman CHAMBLISS. Go ahead with your comments.

Mr. SEVIER. OK; I know there has been some criticism that the program is not getting the money out the door fast enough, but in my opinion, you know, it is a loan program, so there must be relative assurance that the loans will be repaid, and this requires a very solid business plan and due diligence. I know some of the new borrowers probably did not know what to expect from this program. We've been in the program for over 50 years, and we did not have a problem meeting and satisfying the requirements.

You know, RUS has loaned out billions of dollars in rural America and operated a very relatively inexpensive program at little risk. So I guess in summary, I would just say that we are excited about bringing young families back to Western Kansas. We're getting small businesses back because of the RUS Broadband Program that has helped us bring broadband to some of these communities, and I hope it will help us bring broadband to more of the communities.

I'd like to enter into the record, and I can pass this around; this is a map of the broadband coverage that we are serving in Western Kansas, showing that we're serving 100 percent of our area and the different technologies that we're using to do that.

Chairman CHAMBLISS. Good. We will submit that and attach it to your statement, Mr. Sevier.

Mr. SEVIER. OK; thank you.

[The prepared statement of Mr. Sevier can be found on page 52 in the appendix.]

Chairman CHAMBLISS. Thank you very much. Mr. PAGON.

STATEMENT OF MR. MARK PAGON, CHIEF EXECUTIVE OFFICER, PEGASUS COMMUNICATIONS, BALA CYNWYD, PENNSYLVANIA

Mr. PAGON. Good morning, Mr. Chairman and Ranking Member Harkin and Members of the Committee. I'm grateful for your invitation to provide testimony to the Committee in its review of the Rural Development Broadband Loan and Loan Guarantee Program. My name is Mark Pagon. I'm the CEO and founder of Pegasus Communications Corporation and of its subsidiary, Pegasus Rural Broadband. Pegasus Rural Broadband is a facilities-based provider of wireless high speed Internet services to residential,

small business, and enterprise subscribers in underserved and rural communities.

Pegasus Rural Broadband was approved in 2005 for a $13 million loan under the Rural Development Broadband Loan and Loan Guarantee Program in support of our efforts to provide wireless high speed Internet services to approximately 100 rural communities and 400,000 people in the State of Texas.

I have been an entrepreneur for substantially all of my professional life. My strategy has always been to focus on underserved and rural communities, to introduce attractive new services and to price them affordably. In the eighties and early nineties, I started companies providing cable TV and Fox Television in Mississippi, Tennessee, Florida, Alabama, Pennsylvania, Massachusetts, New Hampshire, Connecticut, and the Commonwealth of Puerto Rico. In the nineties, I started a company introducing Direct TV to rural areas in 42 States.

Collectively these companies grew to serve over 1.5 million subscribers, in almost all cases providing new services not previously available in the communities we served. While there are a variety of means to measure success in business, the measure that I believe takes precedence over all others is whether your company has made a difference to the communities it serves. My companies have always striven to meet that goal, and I believe that we have.

Pegasus Rural Broadband was formed with a simple objective: to offer wireless high speed Internet services to rural and underserved communities at an affordable price. We began commercial operation approximately 2 years ago. We are operational in 50 communities in West and Central Texas, and we currently serve approximately 2,500 subscribers. We offer connection speeds up to 1.5 megabits per second and price our services at between $30 and $40 per month. While we have been authorized for a $13 million loan from the RUS under the Rural Development Broadband Loan and Loan Guarantee Program, to date, the capital required to build and operate our business has been wholly contributed by Pegasus Communications.

My experience as an entrepreneur building companies, introducing new services to underserved and rural communities provides me a perspective on the challenges of providing broadband Internet access to rural communities and the importance of the Rural Development Broadband Loan and Loan Guarantee program to meeting this important objective. My observations are, of course, limited by my own experience. I hope you will find them useful.

No. 1, affordable high speed always on Internet access is a necessary element of community health and development in the 21st Century. Communities that lack such services will be severely at risk. Rural communities present two specific challenges to building a financially self-sustaining high speed Internet access service: small population size and low home density.

Small population makes it very difficult to generate the revenues necessary to cover the fixed costs attendant on providing such services, and low home density disadvantages Internet access services whose capital investment is proportional to the geography covered, as the revenue per unit of capital investment shrinks as home density declines.

This is a problem for both wireless and wire line services but is especially problematic for wire line services. For this reason, we believe that wireless high speed Internet services represent an efficient and promising means for providing financially self sustaining high speed Internet services in rural communities.

Wireless technologies have now been introduced that allow for the delivery of commercially viable wireless high speed Internet access services. These include both proprietary technologies and open standard technologies using unlicensed spectrum as well as so-called fourth generation or 4G technologies such as Wi-Max, designed for use in licensed frequency bands. As compared with wire line alternatives, these technologies are relatively inexpensive to build and are efficient for serving low- density geographies.

Companies serving rural communities have traditionally had more limited access to the capital markets than those serving larger metropolitan areas. This is, of course, also true for companies providing services based on newly introduced technologies. As a result, wireless high speed Internet access service providers have to date had great difficulty in securing the capital to launch wireless high- speed Internet services, especially in rural communities.

The Rural Development Broadband Loan and Loan Guarantee Program is one of the few sources of long-term capital available for such wireless high speed access service providers. For Pegasus Rural Broadband, our loan authorization provides an essential supplement to our own investment capital and will enable us to expand our high speed rural Internet services throughout Central and West Texas.

Now, just to provide some background on our experience, we filed our initial application for loan authorization with the RUS in February of 2003. Our application outlined plans to serve approximately 100 eligible communities in Texas. Preparation of our application required substantial commitments of time from six members of our management and financial staff. It took approximately 3 months to complete.

In March of 2003, the RUS deemed our application incomplete and returned it to us. We submitted a revised application in April 2003, and in June 2003, the RUS notified that a revised application had been deemed complete. In June of 2005, we executed definitive loan documentation for our $13 million loan authorization. While we have not yet submitted an initial draw on this loan authorization, we expect to do so within the 90 days.

I would just offer up two observations, comments in support of the program and in improving the program if I might, Mr. Chairman.

Chairman CHAMBLISS. Certainly.

Mr. PAGON. Observation No. 1, suggestion No. 1 is the process of submitting our application, having our application deemed complete, and negotiating and completing loan documentation was considerably more time consuming than we initially expected. Much of our experience is attributable to the fact that we are a first time borrower from the RUS, without prior familiarity with RUS processes or documentation. We believe that our experience will enable us to submit complete and document future loan applications more quickly. However, we suggest that simplification of the loan appli-

cation process by RUS would also be beneficial to expediting review of loan applications under the loan program.

No. 2, currently, the Rural Development Broadband Loan and Loan Guarantee Program prohibits loans to companies proposing services competitive to other applicants or RUS borrowers. The submission of an application for an eligible community blocks the ability of subsequent applicants to file for the same community until such time as the earliest application is deemed complete or is rejected. This imposes some hardship on applicants, as it is difficult to anticipate which communities will be the subject of alternative, competing applications, and when a competing application has been filed, how quickly RUS will make a decision to accept the competing application as complete or to reject it.

We suggest that the Broadband Loan Program would be improved if applicants were allowed to submit applications for any eligible community at any time up to the point that RUS and a competing applicant enter into a definitive loan authorization covering that community. This will enable applicants to file an application for eligible communities at any time and to have their application considered in the order in which the applications were submitted to RUS.

In summary, I believe that the Rural Development Broadband Loan and Loan Guarantee Program is a good program as well as a necessary element to facilitating provision of high speed Internet access services in underserved and rural communities. I also believe that certain modest changes can be made in the existing program to ensure that its promise is fully realized.

Mr. Chairman, Ranking Member Harkin, Members, again, thank you for the invitation to speak to you today.

[The prepared statement of Mr. Pagon can be found on page 48 in the appendix.]

Chairman CHAMBLISS. Thank you very much.

Mr. SIMMONS.

STATEMENT OF TOM SIMMONS, VICE PRESIDENT FOR PUBLIC POLICY, MID-CONTINENT COMMUNICATIONS, SIOUX FALLS, SOUTH DAKOTA

Mr. SIMMONS. Chairman Chambliss and Members of the Committee, thank you for inviting me to testify today. My name is Tom Simmons, and I am the Vice President of Public Policy for Mid-Continent Communications, a leading provider of cable telecommunications services in rural America, including analog and digital cable television, broadband Internet, local and long distance telephone services. We serve over 200,000 customers in approximately 200 communities in North and South Dakota, in Western Minnesota and northern Nebraska, generally classified as small or rural.

The size of our communities range from densities of five to 116 homes per mile of cable plant and populations ranging from less than 30, in Barlow, North Dakota, to our largest community, which is Sioux Falls, South Dakota. That population is just a little over 140,000. Mid——Continent launched its broadband Internet service over 10 years ago on April 15, 1996, in Aberdeen, South Dakota, and made a pledge then to bring advanced broadband services to

as many customers as possible regardless of the size of the community.

By the end of last year, we completed a project to rebuild our cable plants to 750 megahertz or better in 50 more Mid-Continent communities. That brings our total of upgraded systems to 152, now serving over 95 percent of Mid-Continent's customers.

All of this has required Mid-Continent, a privately held company, to invest over $90 million in private risk capital to bring advanced services to our customers in rural America without the assistance of public funds. We hope to continue doing so. We are proud of our ability to deliver the services our customers demand, which are no less than those desired and expected in suburban and major metropolitan areas. As a provider of broadband service in rural America, Mid-Continent strongly supports the fundamental, primary goal of the RUS Broadband Loan Program: to deploy broadband to consumers living in unserved areas of rural America. We believe that quality broadband services should be available to all regions of the country and to all consumers, including those in the least densely populated areas of the country.

However, we have two concerns regarding the RUS Broadband Loan Program which we would encourage the Committee to examine further. First, in many instances, RUS loans are being used to subsidize broadband deployment in areas already served by companies that deployed broadband service without a Government subsidy. This runs counter to the stated purpose of the program: to bring broadband to consumers living in areas where it is unavailable.

A September 2005 USDA Inspector General's report found that the RUS Broadband Loan Program was, and I quote, not maintained its focus on rural communities without preexisting service, unquote. Mr. Chairman, we concur with the IG's report. There are numerous examples of RUS loans being granted in areas already served by one or more providers. In fact, not long ago, the RUS granted a $13 million loan to a company to overbuild Mid-Continent in Mitchell, South Dakota, a small city of a little over 14,500 residents, despite the fact that we faced vibrant competition and invested millions of dollars in risk capital to upgrade our system in Mitchell in order to provide our customers there a variety of advanced services, including high speed Internet services, high definition television, and telephony.

And Mitchell was not the only town overbuilt in South Dakota. As an RUS official reported at a 2004 South Dakota PUC conference, the RUS had approved $37 million in loans to South Dakota companies by that time, but none of that money was targeted to provide broadband service to any of the more than 70 communities in South Dakota that had no access to broadband service.

Mr. Chairman, providing broadband service in high cost rural areas is economically risky at best. That risk could become unbearable if we are faced with a competitor subsidized by the Government. Subsidizing a company to overbuild an existing provider could have the perverse effect of making it increasingly difficult if not impossible for a company that entered the market first using private risk capital to continue to provide quality service in that market. Furthermore, the threat of Government-subsidized com-

petition in rural markets also creates a disincentive for a company that does not receive Federal support to extend support to rural communities, and importantly, subsidizing deployment in a competitive market diverts scarce revenues from areas where a market based solution has not developed.

We are concerned that while the RUS is required to assess the status of broadband service in markets where an applicant is seeking a loan, the existing rules can make it difficult for the RUS to make an accurate assessment. Existing providers often have little or no opportunity to effectively challenge assertions made by an applicant that seeks a loan to overbuild incumbent providers. By not having a clear picture of the marketplace, it may be difficult for the RUS to determine whether it is appropriate to approve the application. A more transparent, open process allowing for disclosure of nonproprietary information to the public would assist RUS staff evaluating loans and benefit the public, whose tax money supports this program. To this end, and reflecting on the two principal concerns, we recommend the following: first, the program should be revamped to carefully and strictly target assistance to support broadband deployment in unserved areas only; and second, the RUS should take steps to, one, ensure that it getting the information it needs to assess the feasibility of loan applications; and two, ensure the public understands the basis on which the loans are made.

In closing, Mr. Chairman, let me reiterate that Mid——Continent supports the goals of the Federal Government to assure that all Americans have access to broadband services. Our industry has invested hundreds of millions of dollars to help that goal become a reality, and we recognize that Government subsidies may be the only answer in some rural areas. However, that program should be designed to promote broadband deployment; and must be carefully defined and targeted to those areas that lack broadband service.

And let me also, sir, add a word of thanks publicly to Mr. Andrew and the members of the RUS who have been willing to meet with our industry to discuss these concerns and work on mutual goals to do right by our customers and your constituents.

Mr. Chairman, thank you for inviting me to testify today. I'd be happy to answer any questions you or Members of the Committee may have.

[The prepared statement of Mr. Simmons can be found on page 57 in the appendix.]

Chairman CHAMBLISS. Well, thanks to all three of you for that information that you respectively provided there.

Mr. Sevier, what is your consumer per mile ratio on your telephone line versus your broadband service line?

Mr. SEVIER. Well, it depends on which program. In our traditional program, we have probably a ratio of 80 percent of broadband customers to our telephony customers. We have around 6,000 to 8,000 broadband customers and 10,000——

Chairman CHAMBLISS. What I meant to ask was how many consumers per mile are on your telephone lines versus your broadband line?

Mr. SEVIER. We have two consumers per mile on the telephone project, and I am not sure that we have done a per mile; I could figure it out relatively easy. It would probably be about——

Chairman CHAMBLISS. Do you think it is more or less than two?

Mr. SEVIER. It is less; it is maybe one, one-half to one per mile. There are a lot of consumers who do not have computers yet, and it is difficult to know how many consumers are out there that do not have computers to be able to get a good ratio of what our penetration is to the number of computers.

Chairman CHAMBLISS. Yes; I hear what Mr. Simmons is saying, and I empathize with his position. Anytime we can encourage the private sector to invest in markets like the expansion of broadband, I think it is important that we do so. But I know from my experience with the rural electric cooperatives that in terms of the customer per mile, two customers per mile makes it difficult to support your telephone operation. If you have less than that on broadband, there's not a lot of incentive for capital investment in the private market.

At the same time, I hear you saying, Mr. Simmons, that you support the program, but it should be going to underserved areas. I think that's a good statement, and that is a fair statement. What effect, from a competition standpoint, does someone who has a government subsidized loan or a government loan come into your market area? What effect does that have on your business on a day-to-day basis?

Mr. SIMMONS. Well, in that particular market, that market, which is already very small, now has been split. Regardless of whatever number of customers that we have or what our market share has been, the pro forma that we built the operation on no longer exists. There will be more players in the marketplace, so obviously, it has an impact on what our margins may be, an impact on our ability to provide services in that particular market.

It might be a different situation if the competitor came into the marketplace and was providing services that were different from ours. But in the example that I offered in my testimony, in Mitchell, South Dakota, the competitor came into the market, provided exactly the same services that were provided in exactly the same service area. So it was purely a competitor to that market.

There is a secondary, unintended consequence of this, however, that may not be apparent. We found in our company that when we take a look at our operation companywide, that's all the communities we serve, it has impacted us in some of the other communities. There may be some communities out there that basically have been upside down for quite some time.

We continue to provide the services there until such time that we're able to build services into that or advance services into that community. But we have found ourselves making a decision in a few of those markets that it no longer makes sense for us to provide any services there. We have, in fact, in a few small towns not renewed our cable franchise. We can't continue serving even the level of services that we provide now in some of those communities, because we have a competitive assault going on in some of our other communities.

So we talk about competition being good, and it is in almost all cases. Competition is important. It is really important for the people who receive the competition. But if money is allocated from the Federal Government into those community areas that might divert it from those unserved areas, it is a failure of the program to serve those people. Even in our case, if we are having to divert our resources to compete in some of these markets, there might be some other smaller communities out there that will also be unserved now even by our cable services.

So this is a very complicated issue, sir, and it goes well beyond the obvious: there are, in fact, unintended consequences.

Chairman CHAMBLISS. When a competitor comes into your market, and let us just use your South Dakota example. Did the Government-subsidized entity that came into that market serve or compete with you with lower rates than what you were able to provide at that point in time?

Mr. SIMMONS. Not necessarily; in some cases, perhaps. But what we have done, you know, the application was made, and again, there's quite a lag time between when the application was made and when the service provision begins. They have to go through an extensive application process, as I understand it, but there is a period of time, usually a year, to build out those services.

From the time that the application was made to the time of deployment, we have a competitor providing all those services, but during that time we have modified our services as well. We've ramped them up substantially; not because of the competition; we have done that throughout our entire service area.

But we have added most recently digital telephone service, VoIP, if you please, to that particular market. So we'll have additional services. Since the time the application was made on our cable plant, we were offering both analog and digital video services, high definition television in those markets, digital video recording capability in those markets, and we will be about to add video on demand in those markets as well, not necessarily because of the competition but as a standard rampup that we do in those particular markets.

And one great concern that I have, Mr. Chairman, with the program is that I'm assuming that the only reason the city of Mitchell received that loan grant was because the RUS had determined Mitchell to be underserved. I do not understand how the city of Mitchell could have been considered underserved with all of those offerings.

Chairman CHAMBLISS. Were any questions asked of you by anyone from RUS at the time that application was under consideration?

Mr. SIMMONS. Mr. Chairman, I have never received a telephone call from anyone at the RUS: not for any information regarding the application or for any matter.

Chairman CHAMBLISS. Mr. Sevier, you have had experience with filing an application for loans both on the telephone side and the broadband side. Again, going back to Mr. Pagon's testimony regarding the significant difficulty his company encountered in filing this application, is there a major difference in the application and the requirements thereof for a telephone loan versus a broadband loan?

Mr. SEVIER. Mr. Chairman, I do not see much of a difference. We have made loans on both of the programs. In fact, we are currently doing a loan application for the Sprint acquisition and rebuild that I mentioned, and the requirements are very thorough. They are very thorough about what they expect us to have in there.

But they are both about the same from what I can tell. One requires a market survey under the Broadband Program, while they do an area coverage survey under the traditional program, so typically, they would be about the same. You have to do your engineering design prior to submitting for the loan, and the differences that I see might be that in the traditional program, there might be more required of an A-loan borrower, which would be the first time a borrower has borrowed from the RUS program.

And so, you're seeing many first-time borrowers in the Broadband Program right now. So I can see a difference in what would be required for that first-time borrower as opposed to an incumbent borrower who has been in several times and that they're familiar with.

Chairman CHAMBLISS. Mr. Pagon, again, along that same line, was that the first loan application you had submitted under this program?

Mr. PAGON. Yes, it was.

Chairman CHAMBLISS. Have you subsequently submitted any additional applications?

Mr. PAGON. We submitted a second application a year and a half ago, and it was returned to us as incomplete, and we have not resubmitted it at this point.

Chairman CHAMBLISS. Again, I empathize with your position, having gone through a number of applications in the electric cooperative business. Those things are a couple of feet thick, as I remember. I think that your concern there has a lot of merit to it. Perhaps we need to emphasize to RUS that we want to make that process a little bit easier to go through. Senator Harkin and I were just talking about this: we have $900 million sitting there, and much of it is not being accessed just because of the difficulty that you encountered in that loan application process.

So, Senator Harkin.

Senator HARKIN. Mr. Chairman, you are right on that, and as we were discussing, we want to get the money out, but we want to make sure that it is reasonable and that we do not make bad loans and everything.

But in that regard, I would just say to each of you that, you know, under the REA, sort of the history of what I have looked at here when we put this in the bill, in the REA, when they started making their loans for extending lines and things like that and even up to the present time, they didn't just take a loan application, process it, and say goodbye. They worked with the applicants to design, to organize, establish a system, provide the services out there. It was a whole service entity. It was not just getting the loan. It was providing a lot of support and help and stuff to get the job done.

I don't detect that in RUS right now. It is sort of we will look at the paperwork and make the loan and good- bye. I'm thinking that there ought to be more of an active involvement with that pro-

gram than what we have right now. I do not think we set it up in the Farm Bill just as a lender, just as a specific lender but as someone who would work with entities and help them out.

With regard to getting—Mr. Simmons, in many cases in the Midwest, cable does a very good job. They got their communities wired. They provide a lot of good services. But there's a kind of conundrum here. There's a problem. In many cases, cable will serve a community; does a great job, but then, they reach beyond the community. Now, we get a place where Mr. Pagon comes in here, and he says, well, we want to serve a rural area out there, but in order to make it cost-effective, to make sure that we can make the plan work, we need to be able to serve some of the community also.

So here I am. I want to be able to get service out to people who live beyond the community limits. Cable won't do it. Here comes along a borrower; they say they can do it, but they need to have access, perhaps, to some of that community also. So, then, what do you say to our constituents who say, yes, we have cable, and it provides good service, but we don't have any competition? It's the only thing we got? And when they raise their prices, we do not have any other place to go.

So you see, we are in a bit of a problem here. We want to get it to rural areas. Cable can't do it, and I understand the monetary reasons; but they can, but they need to have access to the community. How do you solve that problem?

Mr. SIMMONS. Well, Senator, there are a couple of issues in that statement. On the cable competition issue, every market already has satellite competition, so there are choices in the markets right now, and frankly, there is another debate going on within both Commerce Committees in the House and Senate on how we're going to be extending franchises for new providers, presumably in the individual markets. But maybe the core of the question you are asking——

Senator HARKIN. Excuse me, Mr. Simmons; satellite is only downstream.

Mr. SIMMONS. That is correct.

Senator HARKIN. We want to get broadband so people can do both.

Mr. SIMMONS. When we have a provider who is asking for an RUS loan grant into the market that's going to extend well beyond that particular market, the position of my company, if not our industry but certainly for my company, is go for it. That is quite all right. We would not resist that for a minute.

The issue we have is when a broadband, quote unquote, provider is asking for the RUS to provide millions of dollars for a full market overbuild that will be providing not only the broadband component but will be providing all the services of advanced video, cable television services that we provide now, telephony as well, with the broadband component of that, the Internet per se, being just a small piece of that. But they're providing that infrastructure in a community that matches our service area. It is not going outside of that area. It is exactly the same area that we're serving now. We have a problem with that.

Senator HARKIN. I can understand that. That's why I say—and we do have a problem with that. But what if they want to beyond that area, though?

Mr. SIMMONS. Then, they should be allowed to go beyond that area. If they want to be able to serve that community and tie it all into a bundled package, I believe that would be fine.

Senator HARKIN. Well, that would be fine. I think that solves the problem.

Mr. SIMMONS. Senator, I think the question that we're asking with all of this is that we clearly understand——and I honestly do not understand, perhaps; I thought the purpose of the program was to get—to provide service to unserved areas primarily.

Senator HARKIN. That is right.

Mr. SIMMONS. And that the primary job of the program is to take care of that as opposed to just allocating money. I look at the RUS Website, and all the successes are about, "this is how much money we have allocated", and I guess there is cause for celebration in all of that. But I think the real story should be about how many unserved customers have been taken care of?

Senator HARKIN. So you are right on that. You are right on on that, and that is exactly what we intended to do when we put this in the bill, and that preference is listed in law. There is a preference in the law.

The other thing that we might think about here; I didn't bring it up with Mr. Andrew, but some of his people may still be here is that perhaps, Mr. Simmons, you might suggest that when these loan applications come in, there is a preference in the law for underserved areas. But the way the RUS handles the loans now, as I understand, Mr. Chairman is it is first come, first served. You put in your loan application; that is what they look at. Then, if you came in later, that is what they look at.

Perhaps those loan applications that truly serve unserved areas ought to get to the head of the line. Maybe they ought to be considered first. What do you think of that?

Mr. SIMMONS. Well, Senator, I would agree.

Senator HARKIN. I assumed you would. That is why I asked the question.

Mr. SIMMONS. And also, a statement that Mr. Andrew said early on caught my attention when he said about the plaque that said, you know, something to the effect that we will find a way. When we talk about serving areas outside of a community, it doesn't mean that all you need to do is have one household outside the area. We have now found a way to backdoor the situation that says we would provide services beyond.

I would hope that an applicant into a market, if they need to serve this market, at least the majority of it is going to go beyond, outside of that particular market, and it's not going to be one or two or a housing development over here that we will inadvertently pick up in order to say that we have served outside of this primary community. I would hope that would be the case.

Senator HARKIN. Thank you very much.

Thank you, Mr. Chairman.

Chairman CHAMBLISS. Senator Coleman.

Senator COLEMAN. Thank you. I was encouraged to hear from Mr. Andrew, and get Mr. Simmons to respond, is that there has been a level of cooperation involved in those conversations, and I think that is a positive. I still——I am going to follow up with some questions for Mr. Andrew. I'm wondering if we don't have a little kind of a debate here between, you know, whether we're focusing on underserved or unserved and a distinction between the two.

My sense from Mr. Andrew was that—and I thought I heard him say this that, you know, this is about competition, that it is underserved, and so, we could provide more competition. I think, though, the law is pretty clear on this, and for good reason, that we look to areas that are unserved. In fact, I would think that the loan application process, the suggestion of the Senator from Iowa is a good common sense one. If the mission, if the law dictates that we are looking at unserved areas, then, I would suggest that applications should be focused first on unserved areas.

If, for whatever reason, the unserved areas are all filled, and the money has been allocated, and you have some additional applications, I presume there is not an absolute ban on underserved, but the focus really should be on served. My sense is, and even the response to Mr. Andrew, I am not sure that is even as we sit here today a clear focus of what the understanding should be.

And Mr. Pagon, let me ask you a question: if the RUS were to change their policy and concurrently consider multiple broadband applications, are you concerned about how this might affect, slow down the application process?

Mr. PAGON. I am not sure I understand the thrust of your question.

Senator COLEMAN. You were saying that one of your concerns was that you don't get a chance to file the application, to get yours in front of the RUS until they have either processed or gone through the applications in front of you. It's kind of a singular order. I thought you were suggesting, in fact, that the agency should be, you know, kind of processing applications, you know, all at one time, not doing it kind of waiting until one is finished before you go to the next.

Mr. PAGON. No, that was not my intent. What I was speaking to was the process of preparing an application is very involved and very time consuming, and you need to prepare, as I think was the testimony of someone else, that actually, I think it was in Senator Harkin's comments that you have to file separate applications for each community that you propose to serve.

And one of the hardships is that at any point prior to the submission of your application, it may be the case that another applicant files an application for the same community and has the effect of blocking your ability to file for that community. So essentially, all of that effort becomes potentially wasted. There is really not any transparency as to once a competing application is filed for a community, where the RUS is in its review of that application.

So I think sort of succinctly put, what we would propose is greater transparency in the process of applications. I was not suggesting that the RUS should either approve competing applications for the same community under the loan program or that they should propose to consider them concurrently. Having heard some of the back

and forth here just in the past few minutes, I think prioritization, having some type of scoring criteria beyond just first, you know, first come, first served would be something that we would support. I think that would be, you know, would be a real improvement.

Senator COLEMAN. I raised the question of transparency with Mr. Andrew today, and he indicated an understanding that needs to be done. Just to anyone on the panel, would the transparency actions that he talked about today, does that address some of the problems you have had, problems with anticipation of competing applications and some of the other concerns? Anybody want to respond to that?

Mr. SEVIER. I think they are developing a Website of communities that do have broadband service or have loans from the RUS and so that they can ensure that they are not making loans against themselves. So, I think that is getting much clearer today if you look at the communities that they have listed: where have loans been made? Where is broadband being served by a borrower, whether it be with loan funds or other loan funds, so that they, in essence, are not loaning against themselves in this program.

So I think that has gotten much better. I just want to make a comment to the multiple applications: they do accept multiple communities in one application. It is not a separate application for each community. So if have 10 or 15 communities that need broadband service, and you can support those communities in your business model and feasibility study, then, they will accept that.

Senator COLEMAN. Anybody else want to respond to whether the transparency actions talked about are sufficient or whether more needs to be done?

Mr. PAGON. From what I understood of Mr. Andrew's comments, I think what he was suggesting would be definite improvements. It was a little bit unclear to me how far along, how thorough that transparency would be with respect to filed applications and the review, but in general, I think they would be good steps.

Senator COLEMAN. Mr. Simmons.

Mr. SIMMONS. Senator, we have had discussions with the RUS through our industry group, and most of those discussions were, frankly, about disclosure, making it a little bit more transparent. Mr. Andrew mentioned the Website changes. He mentioned that to us as well. We haven't seen them yet. They're promised. So it will be interesting to see what they look like.

We also had made a variety of other recommendations. One was that perhaps loan applicants could identify existing broadband providers in the proposed service area and notify them of their activities, so that we can have a dialog. As I mentioned earlier in one of the questions, to one of the questions, I have not ever been contacted by a member of the RUS. Now, supposedly, field agents are out reviewing the market, trying to understand what is happening in those particular communities. Yet, we have never heard from them.

And in response to a FOIA request, I learned that an applicant had learned about our company from our Website. Yet, our Website contained no information that would be probably useful in that particular application. There are just better ways of obtaining that information. We'd be more than happy to cooperate on any calls

made on any of our members by, you know, field offices or members of the Rural Utilities Service.

Senator COLEMAN. Well, I hope this hearing today will foster a review, then, of those procedures. Certainly, my follow-up questions to Mr. Andrew, I'll take some of these suggestions and see what we get at the RUS.

We want this program to succeed. It is an important program. It is a critical issue. Again, my concern is that we are not focusing enough on the areas that are unserved, and that should be the principal focus. I am sympathetic, Mr. Simmons, to the concern about the difficulty of raising capital for rural investment. The last thing government needs to be doing is to make it more difficult to scare capital away. Capital grows jobs and builds communities, and so, hopefully, this will be a positive public-private partnership, which I think was intended to meet the needs of rural communities so they can be connected to 21st Century technology.

So thank you, Mr. Chairman.

Chairman CHAMBLISS. I think you are exactly right, Senator COLEMAN. The last thing we want to do is have Government-subsidized entities competing with the private sector. There is kind of a delicate balance. I don't know how we totally eliminate the overlap that might be here, but all three of you raise some good points relative not only to competition but also relative to the need for this program to exist, and what we have got to figure out is how we achieve that balance.

Gentlemen, thank you very much. You've been very informative.

Mr. Sevier, you had something else you wanted to add?

Mr. SEVIER. Just wondered if I could make two last comments, if you don't mind, Mr. Chairman.

Chairman CHAMBLISS. Sure.

Mr. SEVIER. One is to perhaps address Senator Harkin's comments about how RUS used to, in the old REA days, go out and provide the assistance in the field to help these new borrowers through the process. I'm not trying to defend the RUS program, because they can do an adequate job of that themselves, but I am just observing what I have seen.

They have taken tremendous budget cuts over the years and probably have a third or a fourth of the personnel today that they used to have in the days when they were doing that, and an example would be the field person that Mr. Simmons has not seen. They have one field man now for maybe two or three States; maybe more, when they used to have two field men per State, an operations man and an engineer, that had more time, each of them, to kind of help walk these borrowers through. They're spread pretty thin today. They're an extremely hard working bunch of individuals, and I have experienced that first hand. So that is one comment.

The other would be something that I would just like to get on the record, I guess, as far as a traditional borrower through the traditional RUS infrastructure program and now a borrower through our subsidiary through the Broadband Program, we are still one company: we consolidate our audit, and we submit an audit to the RUS folks every year, which is a requirement of theirs, and in that audit, we do spell out what our subsidiary, Nex-Tech,

is doing, as well as what our rural telephone service company parent is doing, and then, we consolidate the two, and they have required that we send in a separate audit report to the Broadband Program, which we found to be a little expensive and maybe something that might not be necessary. Since they are 50 feet down the hall, they have access to an audit that we've done on both of our organizations.

And then, second, we have a very diverse subsidiary that is in multiple businesses, and at the time we made our first loan, for example, we had $20 million in assets in other pieces of our business, and they do take a mortgage on the entire property and have the first lien on everything in your business. Perhaps they could consider taking a mortgage on the communities that are financed by the Broadband Program, leaving the rest of the subsidiary available to get some local funding for business expansion for some of the local needs.

Now, it is very onerous to try to get a lien accommodation so that you can get funding elsewhere through a local bank to build a new building or something that you might need for other parts of your business. So those are a couple of suggestions that I'd like to make.

Chairman CHAMBLISS. Very good. Thank you. Your comment relative to a reduction in personnel is an argument in favor of all that paperwork that is required to be submitted for a loan application.

[Laughter.]

Chairman CHAMBLISS. We will leave the record open for 5 days for anyone who wishes to submit questions, and there may very well be some written questions coming to any one or all three of you. I would appreciate your prompt attention to all of those and get them back for the record. Again, I thank you for taking time to come to Washington to participate in this hearing. The information you have provided has been very informative. Thank you, and this hearing is concluded.

[Whereupon, at 12:12 p.m., the Committee adjourned.]

APPENDIX

MAY 17, 2006

Doc. Submitted

Senator Ken Salazar
Senate Committee on Agriculture, Nutrition and Forestry
Hearing to examine Rural Broadband
May 17, 2006
Statement

I first would like to thank Chairman Chambliss and Ranking Member Harkin for holding this hearing today on rural broadband access. I am pleased that in the midst of all the short term crises facing rural America, like rising fuel cost and natural disasters, the Agriculture Committee is wisely holding a hearing on a decidedly long term issue that has far reaching consequences for our nation's rural communities. In addition, I would like to thank the witnesses for taking time to speak with us. I look forward to hearing your testimony.

Mr. Chairman, broadband is fast becoming the circulatory system of the next generation of information technology. Here in the Hart, Russell and Dirksen office buildings, we depend on the fast acquisition of information on a daily basis. In fact, it is hard to imagine the business of the Senate occurring without such technology. Not all Americans, however, share these benefits.

The term "digital divide" has been thrown around quite a bit recently. The phrase was coined by sociologists to describe the growing disparity between those who can access advance communications technology and those who cannot. Unfortunately, much of rural America falls into the latter category. I often speak of the "forgotten America." The gap in broadband access in these communities is another area where Washington seems to be complacent while our rural communities wither on the vine.

When I travel back to the rural counties of Colorado, I visit communities that don't know if they will have enough resources for schools, law enforcement, and health care. An investment in the communications infrastructure of these communities will help bring them into our fast-changing, technologically integrated economy.

The application for these technologies in rural America is readily apparent. Telehealth can bring advanced healthcare to places it couldn't before. Students could access literature, science, and cultural resources that could help them compete with students from across the world. Law enforcement would have quicker access to databases that can help keep communities safe.

In addition, these advanced technologies will encourage commercial investment. Business such as banks and retail will find these areas significantly more appealing if they have an advanced communications infrastructure.

I am pleased that the Rural Broadband Access Loan Program has been funded since 2003 and has been successful in providing millions of dollars in loans. I believe we can further improve this program to ensure that the money is going to the communities that need it

most. I look forward to hearing the thoughts of the witnesses on how we can continue to improve this program

I also recognize that we have a long way to go. I am disappointed that once again the Administration's budget includes zero funding for broadband grants. When this program was first established, the Rural Utilities service received over 300 applications requesting a total of $185 million. By not funding this program, we are sending the wrong message to our rural communities.

Last year I introduced legislation that would help ensure that Congress lives up to its responsibilities to expand broadband access under the last farm bill. Though the bill has been referred to the Finance Committee, I believe that it should be a useful point of reference as we start to discuss the next farm bill.

Specifically, my bill would:

1. Establish a Rural Broadband Office at the Department of Commerce to oversee federal government resources as they relate specifically to broadband;

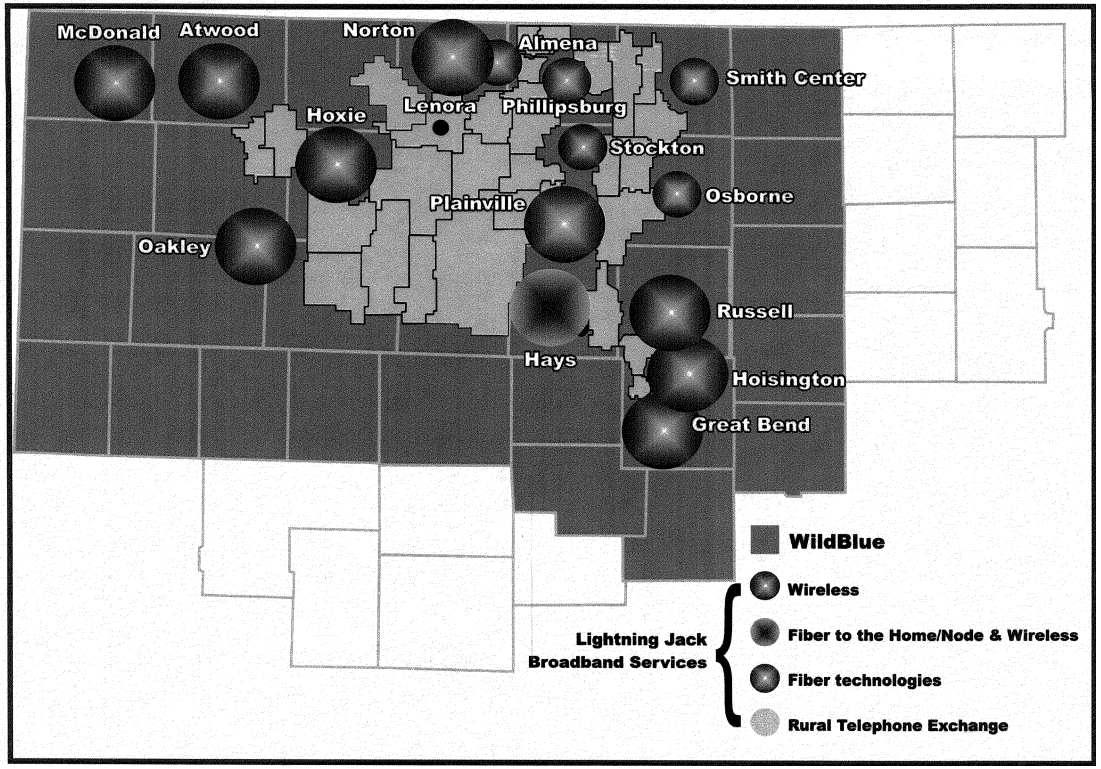
2. Support full funding of the Rural Utility Service Loan Program; and

3. Permit a taxpayer to expense (deduct in a current taxable year), rather than capitalize, certain broadband expenditures and allow tax-exempt mutual or cooperative telephone companies to deduct broadband expenditures against unrelated business taxable income.

We can solve the problem of the rural digital divide. It will take the initiative of this Congress, and I hope this hearing signals a continued commitment to this important issue.

Again, Mr. Chairman and Ranking Member Harkin, I thank you for holding this hearing, and I look forward to the testimony of the witnesses.

Rural Telephone/Nex-Tech Broadband Coverage



Testimony of Jim Andrew

Administrator of Rural Development's Rural Utilities Service

Before the

Senate Committee on Agriculture, Nutrition and Forestry

9:30 a.m. May 17, 2006

Room 328A Russell Senate Office Building

Washington, DC

Chairman Chambliss and members of the Senate Committee on Agriculture, I appreciate the opportunity to appear before you today. I have not had the opportunity to thank you for my very pleasant confirmation hearing last fall, and I do appreciate your help and your courtesy.

You have asked me here today to talk about the Rural Development Broadband Loan program that was authorized in the 2002 Farm Bill. Several of you expressed thoughts on that program when I testified before, and I appreciate your interest and support.

There is nothing else on the horizon today that offers rural communities the opportunity for economic development and the improved quality of life like

the communications revolution, especially broadband. Broadband accessibility is as fundamental for the future of rural communities as railroads and highways were more than a century ago. In today's digital, global economy, broadband and telecommunications cannot be separated from each other.

Information Technology (IT) is producing a dramatic decentralization of information sources. Data can be shared easily across great distances.

To an unprecedented degree people are going to have choices about where to live and how to work. The same is true of businesses. From a rural development perspective, this leverages "Place." It lets you live locally and compete globally.

People no longer need to be in the same building or the same state so they can talk, look at business proposals, or view live pictures of their grandchildren. Business structures, manufacturing, and distribution networks can be located where ever people want to live and work.

This Administration recognizes the potential and the need to seize the opportunity. We are making significant progress toward President Bush's call for universal, affordable access to broadband technology by 2007.

Building broadband is the beginning of this process, not the end. For broadband to have an impact on rural communities, they have to know how to use this technology in their day to day activities. Small businesses and individuals in remote communities can now be just a click away from the global market place. This technology opens doors for business, education and better medical service. With the correct technology and connectivity, you can do business with anyone in the world.

For the Broadband loan program, we adopted the Federal Communications Commission's (FCC) Advanced Services definition of 200 kb in both directions. Moreover, since 2003, we have seen great technological changes in the delivery of high speed communications services.

As I have told some of you before, in the town of Waynesboro, Georgia, my office had broadband. My mechanic, who is located about 100 yards down the road, does not. In my conversation with him, he told me he needs it for

his business to locate parts and communicate with customers and suppliers. We have found that car dealerships will move their business if broadband is not available in a town. My wife still tells me on a regular basis that we do not have broadband at my house.

WHAT DOES RURAL DEVELOPMENT OFFER TO BRING BROADBAND TO RURAL CITIZENS?

The programs under the authority of the USDA Rural Development that play a role in bringing high-speed telecommunications services to Rural America include the telecommunications infrastructure loan program, authorized in 1949, the Rural Broadband Access Loan Program, authorized by the 2002 Farm Bill, the Community Connect Broadband Grant Program, funded through the Distance Learning and Telemedicine Authority, and the Distance Learning and Telemedicine Grant Program, which makes use of high speed telecommunications to provide better quality medical care and improved learning opportunities.

The Rural Broadband Access Loan Program began making loans in 2003. To date, we have approved 57 loan applications for an approximate total of

$872 million to build out broadband access in rural America. The demand for the program remains strong, and we have improved the application process to ensure that we respond to all applications as quickly and as efficiently as possible. Our specialists have reviewed all applications received under this program, and one-third of those applications met the eligibility requirements and received approval for funding. For fiscal year 2006, over $900 million in broadband loan funding is available for new applications.

The applications that have been approved cover a wide range of technologies including digital subscriber line, fiber to the home, hybrid fiber coax, wireless and broadband over powerline facilities. Of the loans that have been approved approximately 23 percent have been to start-up entities. Other entities receiving loans include existing independent telephone companies, rural telephone cooperatives, cable companies and broadband providers.

Statistics compiled from the approved loans indicate that 41 percent of the communities included in the applications did not have access to broadband service, and in 49 percent of the communities not all residents had access to

high speed communications services. The average "take rate" (percentage of those subscribing) for the unserved communities are projected to be 42 percent of households passed and for the underserved communities 12 percent of households passed. (The 12 percent comes from both new users and users that switch from other providers. Information is not yet available for how much overall community use has increased.)

As good stewards of the taxpayers' money, we must make loans that are likely to be repaid. One of the challenges in determining whether a proposed project has a reasonable chance of success is validating the market analysis of the proposed service territory and ensuring that sufficient resources are available to cover operating expenses throughout the construction period until such a time that cash flow from operations become sufficient.

The loan application process that we have developed ensures that the applicant addresses these areas and that appropriate resources are available for maintaining a viable operation. It does no one any good to make a bad loan - not the applicant, not the rural citizens, and not the taxpayer. With

this program, and USDA's other rural development programs, we are making an investments in the futures of these communities.

The broadband program authorized by the 2002 Farm Bill has been a challenge. It is a major new program. We are in the third year of loans. Since I was sworn in as Administrator, I have been working with our staff, looking at both the process and the structure of the broadband program. With this review of all aspects of the broadband program, we will make the changes we can to make this program more user friendly while protecting the taxpayer investment in broadband deployment.

In addition, USDA Rural Development requires any infrastructure built under the traditional telecommunications program to be capable of at least 1 Mbps. This requirement has been in place since the mid 1990s to ensure quality service to rural citizens. USDA's goal is to provide the best quality service possible at a reasonable price for rural citizens.

BROADBAND SUCCESS STORIES

Over a third of the Community Connect Broadband Grants made by USDA Rural Development—27 out of 75—have gone to tribal entities. Other communities with the challenges of distance and time have benefited from this program.

- As one example, the Havasupai—down in the bottom of the Grand Canyon—is the last community in the United States to get mail by mule. In 2005, USDA presented a check for $1.3 million to install wireless broadband Internet service.
- In Hughes, Alaska, a native village of 78 people received funds for a Community Connect grant for that isolated community.
- One of our recipients, Air Advantage in Michigan, won a U.S. Chamber of Commerce award for their service to the communities receiving broadband service through USDA funding.

Projects like these open the door to economic development. In Hughes, for example, the village is going to use its website to facilitate the sale of arts and crafts as well as value-added seafood products. Residents will also be

able to earn income by providing data processing services. Videoconferencing will enhance educational and health care options.

The USDA Broadband programs fit well with not only the other infrastructure programs in electric power and water, but all of the Rural Development initiatives in housing, businesses, community services and cooperative development for stronger rural communities. Improvements in the quality of life for rural citizens, as well as economic development opportunities improve as communities participate in the digital global economy.

The Pew Foundation has done a number of studies on rural broadband deployment. A report that was released in February of 2006, reports some different trends than we have seen in previous years. In the past, we have seen figures that indicated Internet usage was tied to income, education and age.

The numbers we are seeing in this report indicate that availability is the number one factor affecting Internet usage. If broadband service is

available, rural citizens and businesses seem to have as high a usage rate as any urban area.

There are some other issues. On average, it costs three times more to provide service to rural customers, than customers located in urban areas. Availability and affordability cannot be separated.

- Competition improves affordability, and often, the quality of service.

Lack of density and the remote nature of many communities add problems not found in urban areas. Problems such as dealing with environmental challenges or providing wireless service through mountainous areas add to the cost of deployment.

SUMMARY

This is a dynamic industry. It seems like someone comes in my office almost once a week with the latest and greatest way to deploy broadband. Broadband is not an end in itself. It is a tool to be used. It helps to bridge the barriers of time and distance that rural America has faced through the years.

This is an exciting time. One village or town … one business … one family at a time, Rural America is transforming.

It will not happen overnight—but if we do our jobs right, I am convinced that smaller cities, small towns, and rural areas, have a bright future ahead.

Thank you again for this opportunity to discuss this important part of the USDA Rural Development program.

Good Morning Mr. Chairman, Ranking Member Harkin, and Members of the Committee. I am grateful for your invitation to provide testimony to the Committee in its review of the Rural Development Broadband Loan and Loan Guarantee Program.

My name is Mark Pagon. I am the CEO and founder of Pegasus Communications Corporation, and of its subsidiary, Pegasus Rural Broadband, LLC. Pegasus Rural Broadband is a facilities-based provider of wireless high-speed Internet services to residential, small business and enterprise subscribers in underserved and rural communities. Pegasus Rural Broadband was approved in 2005 for a $13 million loan under the Rural Development Broadband Loan and Loan Guarantee Program in support of our efforts to provide wireless high-speed Internet services to approximately 100 rural communities and 400,000 people in the state of Texas.

I have been an entrepreneur for substantially all of my professional life. My strategy has always been to focus on underserved and rural communities, to introduce attractive new services and to price them affordably. In the '80's and early '90's I started companies (Pegasus Cable Television and Pegasus Broadcast Television) providing cable TV and FOX TV in Mississippi, Tennessee, Florida, Alabama, Pennsylvania, Massachusetts, New Hampshire, Connecticut and the Commonwealth of Puerto Rico. In the '90's, I started a company, (Pegasus Satellite Television) introducing DIRECTV to rural areas in 42 states. Collectively, these companies grew to serve over 1.5 million customers; in almost all cases providing new services not previously available in the communities we served. While there are a variety of means to measure success in business, the measure that I believe takes precedence over all others is whether your company has made a difference to the communities its serves. My companies have always striven to meet that goal and I believe that we have.

Pegasus Rural Broadband was formed with a simple objective - to offer wireless high-speed Internet services to rural and underserved communities at an affordable price. We began commercial operation approximately two years ago, we are operational in 50 communities in west and central Texas and we currently serve approximately 2,500 subscribers. We offer connection speeds up to 1.5 MB/s and price our services at between $30 and $40 per month. While we have been authorized for a $13 million loan from the RUS under the Rural Development Broadband Loan and Loan Guarantee Program, to date the capital required to build and operate our business has been wholly contributed by Pegasus Communications.

My experience as an entrepreneur building companies introducing new services to underserved and rural communities provides me a perspective on the challenges of providing broadband Internet access to rural communities and the importance of the Rural Development Broadband Loan and Loan Guarantee Program to meeting this important objective. My observations are, of course, limited by my own experience. They are specific. I hope you will find them pragmatic and useful.

High-Speed Internet Access is an Imperative:

Affordable high-speed, always-on Internet access is a necessary element of community health and development in the 21st century. Communities that lack such services will be severely at-risk.

Building a Financially Self-Sustaining High-Speed Access Service in Rural Communities is a Challenge:

Rural communities present two specific challenges to building a financially self-sustaining high-speed Internet access service – small population and low home density. Small population makes it very difficult to generate the revenues necessary to cover the fixed costs attendant to providing such services. Low home density disadvantages any high-speed Internet access service whose capital investment is proportional to the geography covered, as the revenue potential per unit of capital investment shrinks as home density declines. This is a problem for both wireless and wireline services, but is especially problematic for wireline services. For this reason, I believe that wireless high-speed Internet services represent the most efficient and promising means for providing financially self-sustaining high-speed Internet services in rural communities.

Wireless Technologies Now Exist that Enable the Delivery of Commercially Viable High-Speed Internet Access Services:

Wireless technologies are now being introduced that allow for the delivery of commercially viable wireless high-speed Internet access services. These include both proprietary technologies (provided by companies like Alvarion and Motorola) and open-standard technologies (such as WiFi) using unlicensed spectrum, as well as so-called fourth generation (4G) technologies (such as WiMAX and Flash OFDM) designed for use in licensed frequency bands. As compared with wireline alternatives, these technologies are relatively inexpensive to build and are efficient for serving low density geographies.

The Rural Development Broadband Loan and Loan Guarantee Program is Enabling the Introduction of Wireless High-Speed Internet Access in Many Rural Communities:

Companies serving rural communities have traditionally had more limited access to the capital markets than those primarily serving larger metropolitan areas. This is, of course, also true for companies providing services based upon newly introduced technologies. As a result, wireless high-speed Internet access service providers have to date had great difficulty in securing the capital to launch wireless high-speed Internet services, especially in rural communities. The Rural Development Broadband Loan and Loan Guarantee Program is one of the few sources of long term capital available for such wireless high-speed access service providers. For Pegasus Rural Broadband, our loan authorization provides an essential supplement to our own investment capital and will enable us to expand our high-speed Internet access services throughout central and west Texas.

Our Experience in Applying for and Being Approved for Our Loan Authorization:

We filed our initial application for a loan authorization with the RUS under the Rural Development Broadband Loan and Loan Guarantee Program in February 2003. Our application outlined plans to serve approximately 100 eligible communities in Texas. Preparation of our application required substantial commitments of time from six members of our management and financial staff. It took approximately three months to complete. In March 2003, the RUS deemed our application incomplete and returned it to us. We submitted a revised application in April 2003. In June 2003, the RUS notified us that our revised application had been deemed complete. In June 2005, we executed definitive loan documentation for our $13 million loan authorization. While we have not yet submitted an initial draw under this loan authorization, we expect to do so within the next 90 days.

A Few Suggestions for Improving the Rural Broadband Loan and Loan Guarantee Program:

(1) The process of submitting our application, having our application deemed complete and negotiating and completing loan documentation was considerably more time-consuming than we initially expected. Much of our experience is attributable to the fact that we are a first time borrower from the RUS without prior familiarity with RUS processes or documentation. We believe that our experience will enable us to submit, complete and document future loan applications more quickly. However, we suggest that simplification of the loan application process by RUS would also be beneficial to expediting review of loan applications under this loan program.

(2) Currently, the Rural Development Broadband Loan Program prohibits loans to companies proposing services competitive to other applicants or RUS borrowers. The submission of an application for eligible communities blocks the ability of subsequent applicants to file for the same community until such time as the earliest application is deemed complete or is rejected. This imposes some hardship on applicants, as it is difficult to anticipate which communities will be the subject of alternative, competing applications, and when a competing application has been filed, how quickly RUS will make a decision to accept the competing application as complete or to reject it. We suggest that the Broadband Loan Program would be improved if applicants were allowed to submit applications for any eligible community at any time up to the point that RUS and a competing applicant enter into definitive loan authorization covering that community. This will enable applicants to file an application for eligible communities at any time and to have their application considered in the order in which applications were submitted to RUS.

(3) We believe that the goal of facilitating the introduction of high-speed Internet access to underserved and rural communities would be advance if the definition of an eligible community were expanded to include communities with a population of 35,000 or less.

In summary, I believe that the Rural Development Broadband Loan and Loan Guarantee Program is a good program, as well as a necessary element to facilitating provision of high-speed Internet access services in underserved and rural communities. I also believe that certain, modest changes can be made in the existing program to ensure that its promise is fully realized.

Mr. Chairman, Ranking Member Harkin and Members of the Committee, I again thank you for the invitation to speak before the Committee today.

Testimony of Mr. Larry Sevier

General Manager and Chief Executive Officer

Rural Telephone Service Company

Senate Agriculture, Nutrition and Forestry Committee

May 17, 2006

My name is Larry Sevier. I am the CEO/General Manager for Rural Telephone Service Company and its wholly owned, deregulated subsidiary, Nex-Tech, Inc. Our headquarters is located in Lenora, Kansas, which is a remote region of Northwest Kansas.

Rural Telephone provides voice, video and data services to 10,000 access lines in 29 exchanges in 15 counties, spanning over 5,000 square miles, with an average system density of 2.0 access lines per square mile. We have used the traditional RUS loan program for over 50 years to bring technology services and economic stability to the region. Rural Telephone has been providing high-speed Internet service to its regulated service area since 1998 and every year continues to push fiber deeper into the rural area. Today, through a variety of technologies, DSL, FTTH, and

wireless, Rural Telephone provides reasonably-priced, high-speed Internet service to over 85 percent of its regulated territory. The remainder of its service area is covered with satellite service through WildBlue. The penetration rate for high-speed service in Rural's regulated service area is over 40 percent of households.

Until recently, many of the neighboring communities served by the larger companies did not have broadband service. As a result, economic development was stifled and the outward movement of people continued to escalate. Seeing the need and hearing the despair from the neighboring communities, Rural Telephone wanted to help bring economic stability to the region. It could do so through its deregulated subsidiary, Nex-Tech, if it could find the financing to build in these communities. Funding was difficult to find from the traditional sources. When Nex-Tech learned of the RUS Broadband Pilot Program, it applied immediately for funding for two communities, Norton and Almena. In 2000, Nex-Tech received a loan in the amount of $6,000,000 to bring broadband service to these communities. These are relatively small communities with Norton having a population of 3,000, and Almena a population of 500. With funding from RUS, Nex-Tech built a FTTH system in each community, held community events, went door-to-door signing people to services and opened a local office in Norton. The result was a 70 percent sign-up for telephone services and 25 percent sign-up for broadband prior to construction. Today, Nex-Tech has a telephony penetration rate of 96 percent and a broadband penetration rate of 50 percent in these two communities. The local newspaper editor indicated the initial sign-up event at the American Legion Hall was the largest event he had ever seen in Norton. People were hungry for improved services including broadband.

Nex-Tech has since received three additional loans totaling over $15,000,000 to bring broadband service to five additional communities in Western Kansas ranging in population from 1,500 to 2,700. The same methods were used in these communities and the results, Nex-Tech has a telephony penetration rate of over 80 percent and a broadband penetration rate of 47 percent.

Nex-Tech has also used the satellite broadband program (WildBlue) through NRTC, and while it is a good program for the difficult-to-reach customers, price and speed limitations make a difference on penetration rates. Our penetration rate in the more difficult areas to serve with WildBlue is very low. I would quickly add; however, that this service can be a very useful tool to reach those areas where broadband cannot be provided by other means.

Rural Telephone is currently closing on an acquisition with Sprint to acquire 12 exchanges adjacent to its existing territory. Many of these communities still do not have high-speed Internet service and the ones that do have very limited coverage. We will be utilizing the RUS Program to fund this acquisition and the rebuild of these exchanges with FTTH construction. We look forward to closing on this transaction and providing high-speed Internet service to these communities to help further stabilize the region. There is no question it would be difficult for these communities to provide growth and jobs without adequate high-speed Internet service.

Why are we so passionate about bringing broadband to the communities of Western Kansas? Because our employees live in these communities. These are our friends and neighbors, and we care about the quality of life. It is extremely rewarding to see young families move back to Western Kansas because jobs are being created as small businesses move back. Rural Telephone

and Nex-Tech alone have created over 300 high-tech jobs in the past 15 years. This may not sound like much, but with so many companies downsizing, this says volumes for the stability we are providing. Much of this would not have been possible without the assistance from the RUS Broadband Program.

Are there issues with the Broadband Loan Program and could some things be done differently? Absolutely, but there are no more issues with this program than with any new program. I am aware there has been some criticism about not getting the money out the door quicker, but in my opinion, this being a loan program, not a grant program and dealing with taxpayer dollars, there must be relative assurance that the loans will be repaid. This requires a very solid business plan and more due diligence than many of the new borrowers may have expected. Having been in the traditional RUS Loan Program for over 50 years, we knew what to expect and were able to satisfy their requirements. I know I don't need to remind this Committee of the loan record of zero dollars lost with the traditional RUS Loan Program.

In summary, it would not have been possible to bring broadband service to the communities mentioned in this testimony without the assistance of the RUS Broadband Program. Funding was not available from other sources for these purposes. As a result of the service provided through the RUS Broadband Program, the economy has stabilized in many of these communities. Small business are relocating in Western Kansas once again and young families are moving back to raise their families in the relatively safe and secure environment they dreamed of while having many of the conveniences found only in the cities. This certainly makes the risk of providing

service worthwhile. Thank you for allowing me to bring this information to this committee. I look forward to answering your questions.

Testimony of Tom Simmons

Vice President of Public Policy

Midcontinent Communications

Before the

Senate Committee on Agriculture

on the

RUS Broadband Loan Program

May 17, 2006

Chairman Chambliss and Members of the Committee, thank you for inviting me to testify today. My name is Tom Simmons and I am the Vice President of Public Policy for Midcontinent Communications, a leading provider of cable telecommunications services in rural America, including analog and digital cable television, broadband Internet and local and long distance telephone services. We serve over 200,000 customers in approximately 200 communities in North and South Dakota, Western Minnesota, and Northern Nebraska, generally classified as small or rural. The size of our communities ranges from densities of 5 to 116 homes per mile of cable plant and populations range from less than 30 in Barlow, North Dakota to our largest community, Sioux Falls, South Dakota, which has a population of more than 140,000.

Midcontinent launched its broadband Internet service nearly ten years ago, on April 15, 1996 in Aberdeen, South Dakota, and made a pledge then to bring advanced broadband services to as many customers as possible regardless of the size of the community. At the end of 2005, we completed a project to rebuild our cable plant to 750 MHz or better in 50 more Midcontinent communities, bringing our total of upgraded systems to 152, serving over 95% of Midcontinent's customers.

Customers in these communities now enjoy over 150 channels of analog and digital video programming, broadband Internet service, high definition television, and digital video recording capability. Midcontinent is also a certified local exchange telephone service provider in North Dakota, South Dakota and Minnesota. Midcontinent first launched facility-based circuit switched telephony in 2000, and recently launched its first digital VoIP phone service in Mitchell, South Dakota. Our plans include the rollout of digital phone services in a number of additional communities throughout our service area this year.

All of this has required Midcontinent, a privately held company, to invest over $91,000,000 in private risk capital to bring advanced services to our customers in rural America without the assistance of public funds, and we hope to continue doing so. We're proud of our ability to deliver the services our customers demand, which are no less than those desired and expected in suburban and major metropolitan areas.

As a provider of broadband service in rural America, Midcontinent strongly supports the fundamental, primary goal of the RUS broadband loan program: to deploy broadband to consumers living in unserved areas of rural America. We believe that quality broadband services should be available to all regions of the country, and to all consumers, including those in the least densely populated areas of the country.

However, we are concerned about this program for two reasons: first, because RUS loans are largely being used to subsidize broadband deployment in areas already served by companies that deployed broadband service without a government subsidy, instead of being used to bring broadband

to consumers living in areas where it is unavailable. Second, because RUS rules make it difficult for anyone – existing providers, the public, and even RUS staff, to assess the status of existing broadband service in the market the applicant proposes to serve, whether the applicant's assertions about such broadband are accurate, and whether, given the level of competition and service already in the market, the requested loan is likely to be repaid or is otherwise an appropriate use of taxpayer funds.

With respect to the first point, and as a September 2005 U.S. Department of Agriculture Inspector General's Audit Report on the RUS' Broadband Grant and Loan Programs (OIG Report) found, this program has "not maintained its focus on rural communities without preexisting service" (OIG Report at ii). Instead, it is largely being used to subsidize competition in areas where one, and in many cases, multiple providers of broadband service, exist. To this extent, the private entrepreneurs' reward for being the first risk takers in rural America is to face a government-subsidized competitor.

The RUS itself recognizes the difficulties presented by subsidized competition in rural America. Its own regulations prohibit the granting of a loan in a market where an RUS borrower already exists. The RUS doesn't want to put its borrowers at risk by subsidizing competition. Why should private entrepreneurs be treated any differently?

Providing broadband service in high cost rural areas is economically risky at best. Midcontinent and other cable operators in rural communities all across America have taken that risk. However, that risk could become unbearable if we are faced with a competitor subsidized by the government. Subsidizing a company to overbuild an existing provider could have the perverse effect of making it increasingly difficult, if not impossible, for a company that entered the market first using

private risk capital to continue to provide quality service in that market. The threat of a government subsidized competitor in rural markets also creates a disincentive for a company that does not receive federal support to extend service to rural communities. Additionally, subsidizing competition is a waste of scarce resources that should be targeted to areas where a market-based solution has not developed.

There are numerous examples of loans being granted in areas already served by one or more providers. The case closest to Midcontinent involves Mitchell, South Dakota, a small city of a little over 14,500 residents. When the RUS granted a loan for approximately $13 million to Sancom, Inc. to overbuild us in Mitchell, we were already competing with Qwest for telephone customers, as well as with two DBS companies for each and every video customer. Midcontinent's investment in private risk capital to upgrade our system in Mitchell allowed us to offer our customers a variety of advanced services, including high speed Internet access at speeds of 3 mbps downstream and 256k upstream, which has been further upgraded to 8 mbps downstream. Midcontinent also provides high definition television service, and telephony. VoIP digital phone service is now also available. And Mitchell was not the only town overbuilt in South Dakota. As an RUS official reported at a 2004 South Dakota Public Utilities Commission Wireless Conference in Spearfish, South Dakota, the RUS had approved $37 million in loans to South Dakota companies by that time, but none of that money was targeted to provide broadband service to any of the more than 70 communities in that state that had no access to broadband service.

Other companies have faced similar situations. In Fairfield, Iowa, the RUS granted a $9.475 million loan to an applicant to compete against two existing broadband providers. The cable operator in that case had invested millions of dollars to bring this town of approximately 9,500 people a state-

of-the-art 860 MHz system, with capacity that exceeds or equals the capacity of major metropolitan areas and offers customers high speed Internet access at speeds of 3 mbps downstream and 256k upstream (the operator now offers 5 mbps downstream), 194 video channels, and high definition video service. As the OIG Report makes clear, this has happened time and again, and, as a result, "[the] RUS may be setting its own loans up to fail by encouraging competitive service; it may also be creating an uneven playing field for preexisting providers operating without Government assistance" (OIG Report at ii). To prevent such a scenario, the OIG recommended that before approving such loans, the RUS should conduct objective market research. Without such research, it believed the RUS could issue loans to companies with little chance of survival, which "would not appear to be a suitable use of Federal funds" (OIG Report at 16). The OIG Report illustrates that the RUS broadband loan program, as currently structured, unnecessarily places tax payer dollars at risk, creates unfair subsidized competition, and does little to promote the goals of the Congress and the Administration to bring broadband to every American.

Mr. Chairman, with respect to my second concern regarding the ability of the RUS to collect sufficient data to make an objective determination regarding an application's feasibility, I agree with Under Secretary of Agriculture Thomas Dorr, who at a Senate Commerce Committee hearing on March 6, 2006 said that "[a]s good stewards of the taxpayers' money, [the RUS] must make loans that are likely to be repaid" and that one of the agency's challenges "in determining whether a proposed project has a reasonable chance of success is validating the market analysis of the proposed territory…" (Dorr Testimony at 6). The RUS' own processes, however, make it difficult for the RUS to meet this challenge.

Specifically, the RUS should improve the process in place to solicit the data it needs to validate the applicant's market analysis. The public, including existing providers, receives little notice when RUS applications are filed. Current RUS rules require only a one time legal notice by the applicant in a newspaper of its choice at some time prior to the filing of its loan application. There is no guarantee that an existing provider will see the notice, thereby denying the RUS an accurate picture of the broadband services available in that market.

Furthermore, the RUS does not disclose when an application has been filed, the name of the applicant, the communities the specific applicant proposes to serve, or the assertions made about existing broadband service in a community. It does periodically update an online list of towns and unincorporated rural areas in a state that are covered by pending or approved applications. There is, however, no true public notice and comment period that ensures the public is heard prior to a loan being granted.

In fact, the only way anyone can find out how an applicant is characterizing a market is through a Freedom of Information Act (FOIA) request, and to the best of our knowledge, such requests are usually fulfilled after the application is approved. When Midcontinent finally received a response to its FOIA request on the Mitchell, South Dakota application, we were more than a bit surprised to see that the applicant had blacked out its assertions about our company, apparently based on a claim that this information was proprietary or confidential. Other companies have reported that when they received FOIA responses, they found that applicants had made misstatements about, for example, their Internet speeds, system capacity, quality of service, and the number of video channels being offered.

We believe that the current notice and disclosure rules and practices limit the ability of the RUS to properly assess a loan's likelihood of repayment given the potential lack of data needed to evaluate an applicant's claims, including claims regarding the level of broadband service in a market, claims that existing providers are serving customers poorly, are offering service at insufficient data rates, or are otherwise deficient. A more transparent, open process allowing for disclosure of non-proprietary, non-confidential information to the public would assist RUS staff evaluating loans and benefit the public, whose tax money supports this program. We acknowledge the need to protect proprietary information; but we believe it is essential to make available information being provided in a loan application about third parties and the state of broadband in a market. The RUS should know that information before it fully and fairly represents the market it is evaluating to determine the feasibility of a proposed loan. Absent such information, the RUS has experienced $30.4 million in loan defaults (OIG Report at i).

To this end, and reflecting our two principal concerns with this program, we recommend the following:

- That loans be used to bring broadband to unserved areas only. This certainly is not occurring today; in fact, OIG found that "[i]n some cases, loans were issued to companies in highly competitive business environments where multiple providers competed for relatively few customers." (OIG Report at 15).

- If there is no demand for loans in areas that are unserved, the RUS should let Congress know that this program is not working as intended, and Congress should: (1) modify the legislation in a way that ensures loans will go to unserved areas in rural America; or (2) redirect the

funding into grants aimed at funding broadband deployment in unserved areas. If RUS believes, as reported in the OIG Report, that "[t]here must be economies of scale to make the loan financially feasible." (OIG Report at 9), then perhaps this loan program should be reevaluated to determine a better way to reach unserved America. Today, as the OIG Report noted, the RUS lacks a system "that can guarantee that communities without preexisting service receive priority." (OIG Report at i).

- That the RUS take steps to (1) ensure that it is getting the information it needs to assess the feasibility of loan applications, since the current "legal notice" and Freedom of Information Act process to obtain information do not work, and (2) ensure that the public understands the basis on which loans are made. These steps include:

    1. requiring loan applicants to identify existing broadband providers in their proposed service areas and notify those providers of their intent to seek government loans to compete with them;

    2. requiring loan applicants to provide the RUS a feasibility study or analysis;

    3. publishing notice on the RUS website identifying the applicant and the areas the applicant proposes to serve, giving existing broadband providers at least 30 days following website publication to comment on the application and to notify the RUS of any broadband service already available in targeted areas; including information that would allow the RUS to determine whether and the extent to which the area is served;

4. ensuring that existing providers have the opportunity to supply this information to the RUS **before** the RUS makes a loan decision. The RUS needs this information to determine not only the feasibility of the loan and whether an area is served, but also to determine the impact of a particular loan approval on other providers of broadband service already serving that community;

5. allowing existing broadband providers an opportunity to review the applicants' representations about them and the level of existing broadband service in the targeted market generally. Today, the only way to obtain this information is through FOIA requests; and,

6. making clear the basis on which the RUS determines that an area is "underserved" as justification for approval of a loan in an area where there are already competing broadband providers.

In closing, let me reiterate that Midcontinent supports the goal of the federal government to ensure that all Americans have access to broadband services. We have invested millions of dollars to help that goal become a reality. We recognize that government subsidies may be the only answer in some rural areas. However, any government program designed to promote broadband deployment must be carefully defined and targeted at those areas that lack broadband service. Furthermore, any such program, however well-intentioned, must receive the most stringent government oversight to ensure that government funds are allocated appropriately and that taxpayers are protected.

Mr. Chairman, thank you for inviting me to testify today. I would be happy to answer any questions you or the Members of the Committee may have.

QUESTIONS AND ANSWERS SUBMITTED FOR THE RECORD

MAY 17, 2006

Senator Norm Coleman Questions for the Record

Senate Committee on Agriculture, Nutrition, and Forestry
Full Committee Hearing to Review USDA Rural Utilities Service Broadband Program
Wednesday, May 17, 2006

Mr. Jim Andrew, Administrator, Rural Utilities Service, USDA

1. Mr. Andrew, I know you have expressed your willingness in a past appearance before this Committee to address the concerns laid out in a recent USDA Office of Inspector General (OIG) report that criticized aspects of the broadband program you oversee. One of the recommendations that the Inspector General made in the report was for RUS to clarify its definition of "eligible rural areas" to more effectively implement the program. Congress has made clear its preference for unserved areas, those with no access to broadband, to receive assistance from the broadband loan program ahead of areas that already have some access. The 2002 farm bill states, "In making or guaranteeing loans under paragraph (1), the Secretary shall give priority to eligible rural communities in which broadband service is not available to residential customers." Are you implementing steps to dictate this preference? Do you believe steps could be taken in the application process you oversee to give preference to unserved areas?

2. I believe transparency during the broadband loan application process is important as it affords existing broadband service providers the opportunity to know when an application is under review in their area. These existing providers can then offer RUS a full picture of the broadband service in that area. Surely, RUS would benefit from more information about a loan applicant's area. What steps, aside from providing public notice of applications on the internet, will RUS take to afford greater transparency to the loan application process?

3. Given reports of limited RUS staff to accomplish the thorough and timely reviews of these broadband applications, would you say additional RUS field staff would help you implement this program? What staff levels would be ideal?

Questions submitted by Senator Charles Grassley

Questions for RUS

1)What specific changes has the RUS made in response to the Inspector General's Audit Report of September 2005? What steps is the RUS taking to ensure the accuracy and completeness of the broadband loan applications you receive? To what extent have you implemented the controls recommended by the Inspector General to prioritize communities without broadband access?

2) Representatives of the cable industry have recommended that RUS provide more information about loan applications to incumbent broadband providers, allowing them to comment on the accuracy and completeness of applications. They also suggest that additional information would allow incumbent providers to expand -- at their own expense -- existing infrastructure to reach unserved customers, making taxpayer-funded loans unnecessary. What steps have you taken to open up the loan approval process to incumbent providers and to prompt incumbents to expand their existing broadband systems rather than making government loans?

3) Your testimony indicated that "41% of the communities included in the applications did not have access to broadband, and in 49% not all residents had access to high speed communications services." Please provide a list of the communities in each category. How many applications for communities with no access to broadband have been rejected, returned or otherwise not approved?

4) You indicated that there were $800 million in pending loan applications. Please identify the communities covered by those applications and indicate whether they do not have access to broadband service or whether they are in an area where not all residents have access to high speed communications services.

Senator Tom Harkin

Questions for James Andrew **2**

1) Ubiquitous Broadband by 2007

One of President Bush's most memorable pledges, made in Iowa was that America would have ubiquitous broadband by 2007. That is an important goal. How close are we to reaching it?

I know that is not an easy question. Many communities have broadband serving a small portion of the community. Often that community is counted as having service. But, that is not completely accurate.

You noted in your testimony how he has broadband in Georgia at his office but his mechanic a 100 yards away does not.

Overall the recently released GAO study noted that while 29% of the people in urban areas have broadband, the figure is 17% for rural areas. We have testimony from Larry Sivier that his company was able to acquire penetration rates in some small Kansas towns of 47 and 50%. I assume that those are not the wealthiest of communities.

As we move towards the writing of the next Farm Bill we need some good answers about where the gaps are and how do we help to fill those gaps.

What can RUS do to help us with those questions?

2) I believe that RUS made some fairly substantial errors when they set up the Broadband program in 2002 and 2003. Large applications can cost over $100,000 I am told. Waits can be very long without hearing much. And, the cash requirements are to onerous. I believe that RUS moved away from its traditional practice of managing risk and instead went into a risk avoidance mode. I sent you a lengthy letter on my views about this on December 7, last year and I ask that it be made a part of the record.

Because of the way the program was set up, a dearth of applications occurred for a considerable time and considerable loan capacity was lost, well in excess of a billion dollars, I believe.

The Senate FY 06 Ag Appropriations Report said: "The Committee is concerned that significant portions of rural America remain without broadband service, thus limiting economic opportunity in those areas. The Committee directs that RUS revise its rules and procedures to reduce the burdensome application process and make the program requirements more reasonable, particularly in regard to cash-on-hand requirements".

a) Where is the RUS on revising its procedures and rules?

b) What modifications is RUS considering?

c) Do you think the cash on hand requirements are reasonable? Is it reasonable to not count the stream of funding from existing subscribers?

d) Have you thoughts about a 2 step process for applicants like we have with the telecommunications program?

e) What can the agency do to give applicants a more reasonable expectation of success?

3) Financial Tests

On its web site, the RUS acknowledges that the single largest reason for broadband loan application rejections has to do with meeting the broadband program's financial tests. How do those tests compare with RUS telecomm and electric loan applications?

It has been reported that the 20% equity requirement and 1 year operating cash requirement of the broadband loan program has been a deterrent for applications.

Should existing revenues reasonably believed to be recurring be counted toward one year test?

Is it true that the current financial tests make it more difficult for young companies earning revenues and moving toward profitability to qualify for a loan than it would be for a start-up company with no experience or existing customers?

4) Active Partner vs. Take or Leave It

The history of the REA is one of close and active involvement with those who wanted to connect rural America to modern electric, telephone and water infrastructure. In the early days of the program REA employees worked very closely with applicants to not only finance systems but help design, organize and establish systems and provide services after the loan to ensure good business practices.

Some have described the RUS Broadband program as a Guess what I am thinking program where a near adversarial atmosphere exists between the applicant and the agency.

What can be done to inspire the agency to embrace its broadband mission with the same enthusiasm and creativity in which it embraced rural electrification?

I am told that there is an apparent evolution of some of the broadband loan program's rules and rule interpretations. I am concerned, however, that the evolution may be of a "case by case" nature and that there has been no formal rule changes.

Shouldn't we return to that type of coordination with applicants?

5) Broadband Grant Program

a) The RUS broadband grant program, known as Community Connect has been in place for several years. It seems that the agency has adopted several eligibility tests or scoring criteria for applicants which were designed more to make life easier for applicant evaluators than to tackle the very difficult needs of remote underserved populations.

Unlike the Distance Learning Telemedicine program which uses the school lunch program and allows alternative demonstrations of need, the Broadband grant program uses per capita income as its test of need. For small communities, isn't per capita income a deeply flawed index? I recent met with Warren Buffet in a small group. On a per capita basis everyone in the room was a billionaire! I can assure you that while everyone was enriched by the experience of spending some time with Warren Buffet, everyone left in the same financial shape as before he entered the room.

Questions for the 2nd panel

Question for Mark Pagon

1) I think your experience should help serve as we develop a roadmap of what needs to change in the broadband loan program. You indicate that your application, first made in February, 2003, an application after revisions made in April was deemed complete in June 2003. Then you indicated that you executed definitive loan documentation for the loan in June, 2005. And, now in May, 2006 you hope to make your first draw down against under your loan authorization within 90 days.

So, from the point your application was considered complete, to executing the loan took 2 full years and it is taking another year before you will be drawing down assistance under the loan.

Can you please describe in some detail your experiences with those working on the loan from the point when your loan application was considered complete till June, 2005?

Second, can you explain for the Committee to the extent that it does not disclose any confidential information, why the first draw down is taking over a year?

Questions for Larry Sevier

1) I was very interested in your company's ability to reach broadband market penetrations in the 50% range. That is very impressive.

Can you share with the Committee some of the methods that helped bring that success in some more detail?

2) What is your view of the creating an availability of broadband, not just in communities, but in the completely rural areas. What do you see as the current costs and the current quality of service that is available?

3) You discussed satellite broadband in your testimony. Could you give the committee your thoughts on some of the real problems people have with the technology and the degree to which you have been seeing improvements in the service over time?

For Tom Simmons

1) Mr. Simmons: You have expressed your strong feelings that RUS needs to focus its attention on the completely unserved areas.

And, the Farm Bill does provide for that priority.

Now RUS takes a first come first served consideration of applications. Do you think that one part of the solution might be for applications that are for establishing service in areas with no broadband or perhaps some minimal level of broadband such as only a few served businesses should move to the head of the line?

2) What would you think of providing more generous terms to those that are picking up genuinely unserved areas?

Senator Blanche L. Lincoln
Senate Agriculture Committee Hearing - Rural Broadband
May 17,2006
Questions for the Record

1) Administrator Andrew, your testimony notes that, in your tenure, you have improved the broadband loan application process to ensure that RUS responds to all applications as quickly and efficiently as possible. What specific steps have you taken in this regard?

2) I'm also particularly interested in the Community Connect Grant Program. As I understand it, the scoring criteria for this program gives the maximum points (40) to a community with a population under 499. By the time you reach a community with a population of 2,000 to 3,000, the score is only 20, which makes it difficult for a community of that size to compete.

Given the fact that many tiny communities with a population under 499 often lack the capacity to maintain the program once it is installed, in your view, would it make sense to re-evaluate the scoring criteria to allow slightly larger, though still rural and isolated communities, to be competitive?

3) What is the relationship between broadband programs administered by RUS, the Universal Service Fund programs, and training at Area Health Education Centers or other health centers in rural communities?

Senator Ken Salazar
Senate Committee on Agriculture, Nutrition and Forestry
Hearing Regarding Rural Broadband
Questions
May 17, 2006

Question for Panel 1:

1. The president has set a goal of universal access to broadband services by 2007. While I completely understand that we need to make sure the taxpayers are being served by not granting loans to entities that are unlikely to pay them back, I am concerned that the threshold is high enough to preclude some people from getting the loans despite the fact that they do in fact have the resources to repay them. How do you reconcile the administration's goal of broad access with a program that inherently has high barriers to create that universal access?

2. A major concern with broadband programs is that the government will in effect be subsidizing a company that already has competition in a certain geographic region. This would result in a certain firms competing with another that is, in essence, subsidized by the federal government. What steps are you taking to avoid this kind of unfair situation?

3. It is widely documented that it can be prohibitively expensive to serve highly rural areas. A recent GAO report stated that it may be easier to build non-land-based broadband infrastructure. Has the RUS explored any of these options in the overall context of trying to provide universal access?

4. It seems that some areas are in a catch-22. In these areas, it is prohibitively costly to establish broadband infrastructure without some sort of help. However, the RUS won't provide loans because it is too risky. What are people in these areas supposed to do?

5. Can you comment on your disclosure rules regarding who is receiving these grants? Would full disclosure not help those companies who are planning to expand in an area to know if one of their potential competitors has a federal loan? And isn't removing uncertainty helpful in the effort to achieve universal access?

Question for Panel 2:

6. What improvements can you see being made to this program to continue the goal of universal access?

7. It is clear that the witnesses have had vastly different experiences with the RUS program. To Mr. Sevier, your testimony reflects positively on the RUS program. Have you had any experiences similar to that of Mr. Simmons with regards to competition? Is there anything you believe can be done to improve on the program?

8. [To Mr. Simmons] It is obvious that you, like me, believe in the spirit and goals of the RUS programs. How would you recommend we provide access to these areas where startup is costly and risks are high?

United States Senate Committee on Agriculture, Nutrition and Forestry Hearing Regarding Rural Broadband Program – May 17, 2006

Responses from Larry E. Sevier to Questions from Senators Tom Harkin and Ken Salazar

Questions from Senator Tom Harkin:

Question #1:
I was very interested in your company's ability to reach broadband market penetrations in the 50% range. That is very impressive. Can you share with the committee some of the methods that helped bring that success in some more detail?

Response:
I believe there are several factors which allowed our company to reach a broadband penetration rate of nearly 50%. First and foremost is to provide a very high quality offering at an affordable price. At Rural Telephone, we serve a 5,000 square mile area. We have complete underground facilities with a combination of copper and fiber. We continue to push fiber deeper into our remote rural areas and currently can reach 85% of our customer base with DSL or cable modem. In areas where we cannot reach with these technologies, we have deployed wireless broadband service and satellite through WildBlue. This allows us to offer broadband in our entire service area, as well as other areas of western Kansas that did not have broadband service. We also believe in superior customer service and that has helped keep the penetration level high in spite of sporadic recent competition. We provide a help desk service seven days a week for assistance. We also perform quality assurance on every trouble ticket or new install. I believe our reputation for high quality service in western Kansas and our attention to detail has had a tremendous impact on achieving and maintaining a high penetration rate.

We maintain office locations in several of our larger communities. Where our subsidiary has deployed fiber to the home in AT&T or Sprint communities as a CLEC, we have opened up local offices. People in these rural communities want a local office. While the larger companies are closing offices in the smaller communities and consolidating to the cities, Rural Telephone has seen the value of having customer service representatives in the smaller communities and providing additional employment in these declining areas. This local touch has been instrumental in our gaining and retaining a very high broadband penetration rate.

Question #2:
What is your view of the creating an availability of broadband, not just in communities, but in the completely rural areas. What do you see as the current costs and the current quality of service that is available?

Response:
We not only believe in the concept of bringing broadband to anyone that wants it regardless of where they live, but we are doing so through a variety of technologies. In

areas of western Kansas where we cannot reach affordably with copper and fiber facilities, we have deployed broadband using wireless and satellite technology. Satellite is being offered through WildBlue. The quality of copper and fiber is excellent, and we can price it affordably. Wireless has some limitations as it is line of site to the location and can be blocked by trees. Speeds are very good and wireless can also be priced equivocal with copper and fiber. Satellite service has some limitations in speed. It is also a more expensive technology and the monthly rate is much higher than the other alternatives. However, if high-speed Internet service cannot be delivered by any other means, satellite is an acceptable alternative.

Question #3:
You discussed satellite broadband in your testimony. Could you give the committee your thoughts on some of the real problems people have with the technology and the degree to which you have been seeing improvements in the service over time?

Response:
The issues with the satellite technology versus DSL and cable modem service over fiber and copper are speed and price.

With fiber, we have a tremendous amount of bandwidth and can offer extremely high speeds. Copper DSL is not quite as good as fiber, but is still very impressive. Speeds with satellite are in the range of 512K to a maximum of 1.5 Meg. Pricing is another issue. With DSL and fiber modem pricing, we can offer service at $19.95 to $29.95 for 512K. Our 3 Meg. price is $44.95. Generally the installation is free which includes a modem. With satellite service, there are generally up front costs of $299 for equipment with monthly rates of $49.95 for 512K speed. While this pricing has come down from $600 equipment costs and $99 a month for 200K service, it is still not competitive with fiber or copper.

We continue to offer satellite service in areas that have no other high-speed service.

Questions from Senator Ken Salazar for Panel 2:

Question #6:
What improvements can you see being made to this program to continue the goal of universal service?

Response:
It is very clear, there are still areas of the country that need the RUS Broadband Program to continue the goal of universal access. I think the program has done a great job of safeguarding the funds and making sure that a project is solid and feasible and has a reasonable chance of success, before making a loan. Having said that, many of the loans are made to subsidiaries of existing borrowers from the traditional RUS Loan Program. Our company, for example, has been borrowing from RUS for 50 years and has a very solid track record. Our subsidiary was subjected to the same criteria as a start-up company. We were also required to submit a separate audit report to RUS for our subsidiary operation even though we submit a consolidated audit to RUS through the traditional program. This was an additional cost of $15,000 per year to our company. RUS also required a mortgage on our entire subsidiary for a loan to build broadband in one community. This seemed a little excessive as we had $20 million in assets and were only borrowing $6 million for a new project. Perhaps they should have taken a mortgage on the property that was being financed by that loan and tied the mortgage to that particular community.

Question #7:
It is clear that the witnesses have had vastly different experiences with the RUS Program. To Mr. Sevier, your testimony reflects positively on the RUS Program. Have you had any experiences similar to that of Mr. Simmons with regards to competition? Is there anything you believe can be done to improve on the program?

Response:
Our experience has been just the opposite of Mr. Simmons experience. In some of the communities of western Kansas, cable television providers were providing high-speed Internet through cable modem. Many of these communities were literally begging for competition as the service was extremely poor. In the communities that we overbuilt with fiber to the premise, we captured the majority of the existing broadband customers and penetration rates increased to nearly 50%. We were able to offer greater speeds, more bandwidth, help desk services, and a more stable always on system with few outages. These communities needed an alternative to bring them into the 21st Century.

To answer the last part of the question about improvements to the program, please see the answer to question number 6.

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