

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.