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VIA OVERNIGHT MAIL
Mr. James R. Newby, Acting Administrator
Rural Utilities Service
United States Department of Agriculture
1400 Independence Ave., SW
Washington, DC 20250

RE: Treatment of Capital Leases for Capacity

Dear Mr. Newby:

Level 3 Communications, LLC ("Level 3") urges the Rural Utilities Service ("RUS") to ensure that capitalized capacity leases ("CCLs"), which are considered capital leases under generally accepted accounting principles, be fully eligible for all RUS telecommunications and broadband loan and grant programs.

Level 3 is a facilities-based provider of a broad range of integrated communications services. We couple a broad service portfolio with one of the world's most scalable end-to-end networks to deliver a set of solutions built specifically for the 21st Century. Our network offerings include Internet Protocol ("IP") services, metro and long haul transport services, content and video delivery, data and voice services.

As RUS considers policies to implement the broadband provisions of the Food, Conservation and Energy Act of 2008 and the American Recovery and Reinvestment Act ("ARRA"), it is crucial that RUS promote rules that preserve technological neutrality, and that assure the efficient use of taxpayers' dollars to give consumers access to robust and innovative broadband services.

Legislative Requirements

In 2008, Congress reauthorized the RUS broadband loan program. The legislation is designed to provide "funds for the costs of the construction, improvement, and acquisition of facilities and equipment for broadband service in rural areas." (Sec 601(a) of REA Act).

The Congress also instructed the agency to "use criteria that are technologically neutral." (601(f)).

ARRA is designed to provide grants, loans and loan guarantees for broadband investment giving priority to "project applications for broadband systems that will deliver end users a choice of more than one service provider…." (Title I).

One important goal of the stimulus program is to expend limited federal dollars in an efficient and effective manner.

<u>CCLs Can be Used Efficiently to Advance Broadband</u>

RUS telecommunications, broadband loan financing and ARRA funding is largely focused on infrastructure investment and non-recurring costs. There are several ways to invest in infrastructure which could bring much needed broadband services to areas that have no or insufficient capacity.

In many parts of the nation, particularly in rural areas, one of the primary obstacles to the deployment and improvement of broadband service is the absence of competitively-priced "middle-mile" capacity. Retail Internet Service Providers frequently must purchase expensive transport services on a monthly-recurring charge basis to connect its customers to global Internet interconnection points located in major metropolitan areas that might be hundreds of miles away. In many instances, there is only one carrier offering such transport services, and the cost can be prohibitive. And if the rural ISP is successful in delivering services, the transport expense to reach the Internet can multiply over time – especially as the ISP's retail customers use the Internet to access more capacity-intensive applications.

One of the most efficient methods to expand last mile capacity is to create new access points on existing national, high capacity "backbone" Internet networks which traverse or are near unserved or underserved areas. There is no need for these retail ISPs to re-create and duplicate the infrastructure investments that have already been made. Rather, creating new access points on existing backbone networks can bring large amounts of bandwidth to communities for a fraction of the cost. There are two basic means to provide that type of access.

1) The backbone network operator could construct the access point and secure a contract with the ISP to provide service on a month-to-month or short term contract. These Internet Service Providers, however, frequently prefer the certainty of "owning" capacity for longer periods of time, and prefer to incur capital expenses rather than shorter term operating expenses. Furthermore, such providers often seek additional last mile improvements which could be incorporated into project budgets.

2) The ISP could procure a long term CCL which would provide a guaranteed undivided amount of capacity for a stated and lengthy period of time. If structured as a capital lease, the expense associated with the acquisition of capacity would be eligible for capital expense treatment under GAAP. The payment structure of such arrangements could include lump sum up-front payments or payments structured over time; GAAP allow both types of arrangements to be capitalized provided certain conditions are satisfied.

Over the years, RUS has made capital leases eligible for financing. As the agency considers new regulations to implement the broadband provisions required by the 2008 Farm Bill changes and a NOFA to implement the ARRA broadband provisions, the Agency should make it very clear that CCLs are eligible for RUS grant and loan funds.

CCLs and IRUs

In the 1990's, indefeasible rights of use ("IRU") agreements became popular as a means to share fiber, satellite capacity and transoceanic capacity. The term "IRU" is not well-defined and can refer to a variety of interests that might be conveyed in fiber, capacity, satellite systems or transoceanic cable systems. In 2007, RUS issued proposed rules for the broadband loan program. In that proposed regulation, the agency stated that an IRU should not be eligible for financing by the RUS broadband loan program. (Federal Register: May 11, 2007 Page 26742-26759).

In the 2008 Farm Bill, Congress acted to amend Title VI of the Rural Electrification Act (the RUS broadband loan program) before the proposed rules went into effect.

RUS should make it clear that CCLs which are capitalized under GAAP are eligible to be financed by the Agency's broadband loan and grant programs. Under GAAP, a lease of identified capacity whose term exceeds 75% of the underlying assets' estimated useful life is eligible to be classified as a CCL. Using a CCL, a last mile provider could procure precisely the capacity it needs when needed to serve its community. This option is well tailored for rural communities. It is scalable and allows service providers to secure smaller amounts of capacity as an initial matter, adding to the capacity only when demands require. It also adds to project sustainability by reducing both operating and maintenance costs. As an agreement which would meet the strict terms of a capital lease, a CCL can be pledged as an intangible personal property asset of the carrier, providing security for any lender including the government.

Allowing RUS funding for CCL acquisition expenses has the added benefit of allowing multiple RUS recipients to use identified capacity on a specific system, but capture the lower costs associated with the sharing of common transport expenses. If CCLs are not eligible for funding, and multiple carriers in a state procure separate middle-mile transport systems, both up-front costs (borne by the taxpayers under ARRA) as well as ongoing operating expenses (borne by each ISP separately, and likely passed on to consumers) will be dramatically higher.

Recognizing and funding the acquisition of CCLs allows the taxpayers to leverage existing fiber and electronics, as well as to reduce ongoing operating expenses of the retail Internet Service Providers.

Clear Statement Would Avoid Confusion

It is important that RUS' previous concerns about traditional IRUs – which are not rigorously defined – not be confused with the legitimate and prudent use of CCLs. RUS should clarify that CCLs may be eligible for loan and grant consideration. A CCL is an affordable method to deliver modern broadband services in the most cost effective, scalable way. Failure to permit funding for procurement of CCLs would force rural carriers to act in ways that are not consistent with sound economics – some might, for example, seek funding for the deployment of fiber and transmission equipment that would operate in parallel to an already-deployed high-speed backbone network. Tapping into and using the existing network is a far more efficient use of facilities.

Conclusion

We believe that CCLs which are compliant with GAAP rules related to capital leases should be fully financeable under the 2008 Farm Bill, and eligible for ARRA broadband grant and loan funds.

~~If you have any questions, please do not hesitate to call me.~~

Sincerely,

John M. Ryan
Assistant Chief Legal Officer