

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Connect America Fund)	WC Docket No. 10-90
)	
High-Cost Universal Service Support)	WC Docket No. 05-337

COMMENTS OF PUERTO RICO TELEPHONE COMPANY, INC.

I. Introduction

Puerto Rico Telephone Company, Inc. (“PRT”) hereby submits these comments in response to the June 8, 2012 *Public Notice* (“*Notice*”) in the above-captioned proceedings, in which the Wireline Competition Bureau (“Bureau”) seeks comment on a number of issues regarding design and data inputs for Phase II of the Connect America Fund (“CAF”).¹ PRT urges the Federal Communications Commission (“FCC” or “Commission”) either to remove Puerto Rico from the CAF Phase II cost model and maintain existing Universal Service Fund (“USF”) support for broadband, or to adopt a separate methodology that not only considers “costs” but also the “challenges that differ from those faced by carriers in the contiguous 48 states.”² Those challenges include serving one of the poorest populations in the United States of America. Any “cost model” that does not take into account the reduced ability to recover those costs due to the impact of affordability on customer take rates is inadequate when applied to insular areas like Puerto Rico.

¹ *Wireline Competition Bureau Seeks Comment on Model Design and Data Inputs for Phase II of the Connect America Fund*, Public Notice, WC Docket Nos. 10-90 and 05-337, DA 12-911 (rel. Jun. 8, 2012) (“*Notice*”).

² *Connect America Fund*, WC Docket No. 10-90, *et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17737, ¶ 196 (2011) (“*USF/ICC Order*”).

II. Background

Under Phase II of the CAF, the Commission will apply a forward-looking cost model to support deployment of networks providing both voice and broadband service for five years.³ Using this model, the Commission will estimate the support necessary to serve areas where costs are above a specified benchmark, but below a second “extremely high-cost” benchmark.⁴ The Commission will then offer each price cap carrier a model-derived support amount in exchange for a commitment to serve all locations in its service territory in a state that, based on the model, fall within the high-cost range and are not served by a competing, unsubsidized provider.⁵

In the *USF/ICC Order*, the Commission noted that:

[p]rice cap carriers serving Alaska, Hawaii, Puerto Rico, the U.S. Virgin Islands and Northern Marianas Islands argue they face operating conditions and challenges that differ from those faced by carriers in the contiguous 48 states. We direct the Wireline Competition Bureau to consider the unique circumstances of these areas when adopting a cost model, and we further direct the Wireline Competition Bureau to consider whether the model ultimately adopted adequately accounts for the costs faced by carriers serving these areas. If, after reviewing the evidence, the Wireline Competition Bureau determines that the model ultimately adopted does not provide sufficient support to any of these areas, the Bureau may maintain existing support levels, as modified in this Order, to any affected price cap carrier, without exceeding the overall budget of \$1.8 billion per year for price cap areas.⁶

As demonstrated in these comments, and as PRT has previously argued, this approach will severely cripple both voice and broadband investment in Puerto Rico.

³ *USF/ICC Order*, 26 FCC Rcd at 17725, ¶ 156.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 17737-38, ¶ 193 (citations omitted).

III. The Commission's Proposed One-Size-Fits-All, Forward-Looking Cost Model Approach Based on Inputs From the U.S. Mainland Simply Does Not Work for Puerto Rico.

The Commission's mainland cost-model approach has demonstrably failed Puerto Rico. The FCC first moved Puerto Rico to a forward-looking cost model in 2001.⁷ This shift in approach for supporting wireline infrastructure reduced PRT's high-cost loop support to zero causing Puerto Rico to substantially lag behind the rest of the country in wireline infrastructure deployment. For example, when compared to rural rate of return carriers who benefitted from increased universal service support for fiber enhancements to loop infrastructure, PRT faced decreasing loop support and an extremely challenging business environment for purposes of recovering the costs of loop improvements. The FCC continued this arbitrary approach with its Phase I CAF in this proceeding. Phase I CAF provided Puerto Rico no support⁸ even though the Commission has repeatedly identified Puerto Rico as the jurisdiction most in need of support for broadband.

The Commission once again has determined that price cap carrier funding for the provisioning of broadband service in areas where its provision is not economically viable should be determined on the basis of cost estimates derived from a forward-looking model.⁹ However, any nationwide cost-model approach ultimately adopted by the Commission for Phase II of the CAF will not lead to the distribution of adequate support for broadband deployment to unserved areas in Puerto Rico. At least two misguided assumptions likely to be present in any one-size-

⁷ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 99-306, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20451-52, ¶ 34 (1999).

⁸ See *Wireline Competition Bureau Announces Support Amounts For Connect America Fund Phase One Incremental Support*, WC Docket Nos. 10-90, 05-337, DA 12-639, Public Notice (rel. Apr. 25, 2012).

⁹ *USF/ICC Order*, 26 FCC Rcd at 17727, ¶ 166.

fits-all cost model would preclude providers in Puerto Rico from obtaining adequate levels of support to deploy broadband in unserved areas: (i) cost models generally assume that high population density correlates with high subscribership rates—which is not the case the in Puerto Rico, and (ii) a non-insular areas specific cost model cannot quantify the additional costs imposed by the FCC’s legacy of underfunding wireline networks in Puerto Rico.

First, the ABC Coalition Model filed by a coalition of mainland-based price cap carriers, as well as the models the Commission has considered in the past have relied heavily on line density, using the assumption that the take rate for broadband in unserved areas will be comparable to the take rate in served areas with similar demographics.¹⁰ But no served area in the nation has demographics that are “comparable” to Puerto Rico.¹¹ Puerto Rico is poorer than any state, with 45 percent of population living below the poverty line.¹² In fact, the potential customer base in Puerto Rico has the lowest median household income in the United States at \$21,645.¹³ By contrast, Mississippi, the poorest state in the country, has a median household income of \$37,985 and the national median household income is more than double that of Puerto

¹⁰ See *The Broadband Availability Gap*, Omnibus Broadband Initiative Technical Paper No. 1, Federal Communications Commission, at 3 (April 2010), available at Appendix C of *Connect America Fund; A National Broadband Plan for Our Future; High-Cost Universal Service Support*, WC Docket Nos. 10-90, 05-337 and GN Docket No. 09-51, FCC 10-58, Notice of Inquiry and Notice of Proposed Rulemaking, 25 FCC Rcd 6657 (2010).

¹¹ This difference in providing service in Puerto Rico versus the mainland is another example of a violation of the homogeneity assumption that a nationwide model relies on. For a model to provide reliable estimates across a group of companies, the companies must be relatively similar with any differences able to be reflected by variations in model inputs.

¹² Selected Population Profile, American Community Survey 2010 1-Year Estimate, Puerto Rico available at http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_10_1YR_S0201PR&prodType=table (last visited July 5, 2012).

¹³ *Id.*

Rico at \$49,445.¹⁴ Moreover, the Puerto Rico economy is worse off—in February 2012, Puerto Rico’s employment rate stood at 15 percent,¹⁵ nearly double the national unemployment rate of 8.2 percent, and higher than Mississippi’s unemployment rate of 9.5 percent.¹⁶

Historically, this poverty has fostered very low adoption rates for all services. The FCC’s *Seventh Broadband Report* indicates that, in Puerto Rico, nearly three-fourths of the population remains unserved by broadband at speeds of 3 Mbps downstream and 768 kbps upstream compared with just 8% of the population of all states and territories with unserved areas.¹⁷ Puerto Rico also has by far the lowest telephone penetration rate of any U.S. state—at least 4 percentage points lower than the national average. Prior Census studies suggest the actual wireline telephone penetration rate may lie somewhere between 73 and 80 percent—well below the U.S. average of 97.5 percent.

Second, a cost model cannot account for the impact of the Commission’s failed, legacy universal service policy in Puerto Rico, which did not incentivize wireline infrastructure investment. Puerto Rico already suffers from inadequate telecommunications infrastructure compared to the rest of the country. Any cost model that the Commission likely would adopt

¹⁴ United States Census, State Median Income Data, 2010 *available at* <http://www.census.gov/hhes/www/income/data/statemedian/> (last visited July 5, 2012).

¹⁵ “Economy at a Glance: Puerto Rico,” Bureau of Labor Statistics, *available at* <http://www.bls.gov/eag/eag.pr.htm> (last visited July 5, 2012).

¹⁶ “Economy at a Glance: Mississippi,” Bureau of Labor Statistics, *available at* <http://www.bls.gov/eag/eag.ms.htm> (last visited July 5, 2012); “Economy at a Glance: United States,” Bureau of Labor Statistics, *available at* <http://www.bls.gov/eag/eag.us.htm> (last visited July 5, 2012).

¹⁷ *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Docket No. 10-159, FCC 11-78, Seventh Broadband Progress Report and Order on Reconsideration, 26 FCC Rcd 8008, Appendix D (2011) (reporting Form 477 census tract data).

would be premised on leveraging existing wireline networks and would formulate cost conclusions based data from states with more extensive build-out than Puerto Rico.

Consequently, even if a cost model could account for some of the higher operational costs that PRT faces as an insular carrier – including higher shipping costs and higher costs associated with deploying and maintaining infrastructure in Puerto Rico’s tropical climate and difficult terrain – a cost model based on inputs from the mainland U.S. would not adequately account for Puerto Rico’s exceptionally low subscribership rates.

For these reasons, and unless the Bureau is able to pursue a tailored cost-model approach that addresses the unique and compelling needs of Puerto Rico and other insular areas, the Bureau should not include Puerto Rico in any such cost model. In the alternative, and, at a minimum, the Commission must ensure that PRT is allowed to retain its frozen legacy universal service support until telephone and broadband penetration rates in Puerto Rico are on par with the rest of the nation.

IV. The Commission’s Cost Model Approach Fails to Account for the Exorbitant Costs of Providing Broadband Service In Puerto Rico.

The Commission’s cost model approach will be a national model that purports to estimate costs in every price cap study area under assumptions of nationwide inputs and a common network topology. By necessity, any such model will rely on the assumption that the carriers whose costs it is estimating are largely homogeneous with respect to network design and input and labor prices. Such an approach does not take into consideration the extraordinary cost of providing broadband service in insular areas such as Puerto Rico.

For instance, the cost model proposed by the ABC Coalition develops costs up to the nearest Internet peering location but assumes that the peering location is located at a regional tandem within the same LATA and that it is connected to the customer’s premise via a regional

fiber ring. However, this is not the case in Puerto Rico. The lack of an Internet peering location in Puerto Rico requires that middle mile transport be provided via undersea cable from Puerto Rico to peering points located in the continental U.S. via undersea cable. The need for transport via undersea cable systems introduces costs that will not be present in a national model that assumes backhaul via fiber to a point on a regional ring within the same LATA. Another insular area, Alaska, also faces the same challenge.¹⁸ The cost of the undersea cable must be determined and included in any broadband cost estimated used to determine USF distributions for Puerto Rico. PRT is currently in the process of developing the per line cost of the undersea cable connection between Puerto Rico and Florida and will submit its estimate to the Commission when it becomes available.¹⁹

Prior PRT pleadings have also highlighted to the Commission issues unique to Puerto Rico that contribute to higher costs. These include: (a) higher shipping-related costs, because all the supplies necessary for creating and maintaining a telecommunications infrastructure must be shipped and stored at considerable expense; (b) higher operational costs associated with the topography of Puerto Rico, such as the rough, hilly terrain and heavy tropical vegetation in sparsely populated inland areas; (c) higher operational costs associated with the climate of Puerto Rico, which is corrosive and inhospitable to telecommunications equipment, leading to

¹⁸ See Letter from Karen Brinkmann, Counsel for Alaska Communications, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Dockets 10-90 and 05-337, *Alaska Communications Broadband Network Cost Study Model, Methodology and Assumptions*, at 2 (filed Feb. 13, 2012) (“ACS Cost Model”) (noting that the lack of an Internet peering location in Alaska requires that middle mile transport be provided via undersea cable from the state to peering locations in Seattle, Washington and Portland, Oregon).

¹⁹ When faced with the similar issue, Alaska Communications Systems Group, Inc. reported that, “the ACS Model shows that the costs to provide broadband service will exceed by a significant amount the estimates of a national model that assumes backhaul up to a point on a regional ring within the same LATA.” *ACS Cost Model*, at 2. Based on preliminary analysis, Puerto Rico believes that its actual cost to provision broadband to all customers also significantly exceed those estimated by the ABC Coalition model.

accelerated deterioration of equipment; and (d) higher operational costs associated with severe tropical weather in the Caribbean, which requires frequent reconstruction of existing infrastructure due to storm and hurricane damage.²⁰ For these reasons, the use of a nationwide model such as the ABC Coalition model will not yield broadband deployment cost estimates for Puerto Rico that fully reflect the costs of providing service on the island.²¹ As a result, the level of support generated by the current version of the ABC Coalition model will underestimate the level of support needed to make ubiquitous deployment of broadband financially viable in Puerto Rico.

²⁰ See e.g., Reply Comments of Puerto Rico Telephone Company, Inc., WC Docket Nos. 10-90, 07-135, 05-337, 03-109; GN Docket No. 09-51; and CC Docket Nos. 01-92 and 96-45, at 3 (filed Sept. 6, 2011); Comments of Puerto Rico Telephone Company, Inc., WC Docket Nos. 10-90, 07-135, 05-337, 03-109; GN Docket No. 09-51; and CC Docket Nos. 01-92 and 96-45, at 7 (filed Aug. 24, 2011); Reply Comments of Puerto Rico Telephone Company, Inc., WC Docket Nos. 10-90, 07-135, 05-337, 03-109; GN Docket No. 09-51; and CC Docket Nos. 01-92 and 96-45, at 5-6 (filed May 23, 2011).

²¹ Complicating the task of evaluating the ability of the ABC Coalition model to estimate broadband costs in Puerto Rico with any degree of accuracy is the ABC Coalition model's lack of transparency. Despite the Commission's directive that the "model and all underlying data, formulae, computations, and software associated with the model must be available to all interested parties for review and comment" and that "[a]ll underlying data should be verifiable, engineering assumptions reasonable, and outputs plausible," access to the CostQuest Broadband Analysis Tool (CQBAT) model proposed by the ABC Coalition has been very limited even to non-coalition members that are directly affected by the application of its result. See *USF/ICC Order*, 26 FCC Rcd at 17735, ¶ 185 (citations omitted). Access to the CQBAT model's mechanisms has been insufficient to enable meaningful third-party analysis of underlying assumptions regarding network engineering parameters and depreciation assumptions. In addition, CQBAT model information provided thus far is insufficient for third-party analysis of cost inputs used in the model, including equipment costs, labor rates and loadings, and cost of capital. For example, inputs values often are described as "simple averages," but the related information sources, the ranges of data that comprise the averages and supporting documentation are not provided. In addition, engineering assumptions that lead to the sizing of plant capacity, e.g., gauge of cable, DSLAM capacity, etc., are not provided in CQBAT support documentation, and neither are descriptions and explanations of the regression analyses used to determine certain materials costs.

The combination of (i) the underestimation of the true deployment and operating costs in Puerto Rico and (ii) the understated per customer costs and the overstated revenue expectation resulting from the use of an inflated take rate would result in insufficient customer and support revenues. In such a case, a carrier will have no choice but to abandon the provision of service in these areas. The ramifications of such a result go beyond the incumbent LEC's decision not to commit to broadband deployment. Under the terms set forth in the *USF/ICC Order*, should the incumbent LEC decline to commit to full broadband deployment over the initial five-year period, support will be awarded on a competitive bid basis. However, the commitment to full broadband deployment is meaningless if the FCC does not provide adequate model support to serve any of the unserved areas. Thus, the competitive bidding process would not be a solution to the problem of the Commission's model failing to appropriately capture all the costs of providing service in Puerto Rico.

PRT is very concerned that a nationwide cost model approach such as the ABC Coalition model, if adopted, will significantly underestimate broadband costs in Puerto Rico. The current version of the ABC Coalition model, assuming a supported per line range from \$80 to \$256, calculates support for PRT at \$1.7 million annually. PRT currently receives approximately \$36 million in frozen high cost support for the provision of voice service throughout the island. These numbers indicate that the current version of the ABC Coalition model results in a reduction of support in excess of 95 percent of the current levels *which were derived for the purposes of supporting voice service only*. The *USF/ICC Order* acknowledges the potential disruption to voice and other currently supported obligations that the transition to broadband-based support may cause.²² Reducing current support levels by 95 percent because of the use of

²² *USF/ICC Order*, 26 FCC Rcd at 17727, ¶ 165.

a nationwide model that cannot account for the unique circumstances found in Puerto Rico would simply be catastrophic to consumers in Puerto Rico.

V. Responses to Specific Issues Raised in the *Notice*

As PRT has demonstrated, any cost model based on inputs from the U.S. mainland will not provide sufficient support to Puerto Rico for the deployment of broadband service in unserved areas. Therefore, the Bureau should not include Puerto Rico in any cost model or, in the alternative, it should exempt Puerto Rico from the national cost-model approach. However, to the extent the Bureau decides to adopt a national cost-model approach based on the continental United States, PRT offers the following comments on certain issues raised by the Bureau in the *Notice* that have a specific impact on insular carriers.

a. Green-field vs. Brown-field Approach to Network Design. The *Notice* asks whether the model should be based on a green-field or brown-field network design.²³ PRT believes that the green-field approach is by far the best option discussed by the Commission. As discussed in the *Notice*, a brown-field approach may lower the amount of funding needed, but it opens up a host of other issues, leading to the creation of “winners and losers” depending upon a what stage a carrier’s network development currently resides. Further because of the different starting points amongst carriers, the brown-field approach is inconsistent with a one-size-fits-all model because it reduces the level of homogeneity between carriers and, as discussed in the *Notice*, will underestimate the support needed when the starting point for many carriers has been reached only because the carrier has been receiving support. Variations in age, quality, and size of existing plants, and differences in the condition of existing copper deployments (if such data even exists) all require the model to rely on a series of assumptions related to average conditions

²³ *Notice*, ¶¶ 16-18.

across carriers, which weakens the homogeneity assumption upon which a nationwide modeling approach relies.²⁴ Consequently, the green-field method²⁴ represents the best approach for capturing the relative costs across carriers.

b. Modeling Should be Across the Entire Service Area. The *Notice* asks whether the model should estimate the total costs of serving the entire service area and allocate the costs to supported areas, or whether it should only estimate the standalone costs of areas eligible for support.²⁵ PRT agrees with the Bureau's proposal to model costs across the entire study areas in order to properly distribute shared costs. Even if support is to be based on only a portion of the entire study area, the costs for the portion that is supported must reflect that it is part of a larger study area. PRT further agrees that the subtractive approach proposed by the Bureau is a reasonable way to determine the total costs of the portion of the study area that is supported.

c. The Terminal Value of Network Assumption is Critical to Model. In conjunction with the Bureau's consideration of the network design to be used in modeling costs for CAF Phase II support, the *Notice* also seeks comment on the proper terminal value to assign to the modeled network at the end of the five-year support period for CAF Phase II, and whether that terminal value should be book value, commercial/economic value, or zero value.²⁶ PRT agrees with the Bureau that setting the proper terminal value is a difficult issue in light of the fact that only five years of CAF Phase II support is guaranteed. As the Bureau noted, it is impractical to base critical support on unreliable forecasts of commercial/economic value. As further explained by the Bureau, if the terminal value for assets with economic lives in excess of five years is set according to book value, then carriers will have stranded investment costs if support migrates to

²⁴ *Id.* at ¶ 35.

²⁵ *Id.* at ¶¶ 40-48.

²⁶ *Id.* at ¶¶ 12-39.

a different carrier in the sixth year. Setting terminal value at zero is the only way that carriers can attempt to recover their costs since there is no guarantee of support beyond the five-year mark. The Bureau must give appropriate consideration to what happens to carriers that lose support after the five-year mark. As previously discussed, after the five-year CAF II period, networks will need to be operated and maintained based on revenue from subscriber charges. This means that “take rate” and end user prices are critical factors in sustaining the broadband networks that CAF Phase II funding builds. If broadband services are not affordable or desired, then carriers will not have sufficient subscriber revenue to sustain the network. The ABC Coalition model has assumed a 90 percent “take rate,”²⁷ but in Puerto Rico the “take rate” for broadband services has been below the 30 percent mark.²⁸ Setting a terminal value at anything other than zero will increase the risk that must be considered by both ILECs and competitive carriers when they bid on support. Consideration of that risk may result in carriers declining support and short circuiting the entire purpose of USF reform.

d. Nationwide Cost Benchmarks do not Reflect the Differences Faced by Insular Carriers. The *Notice* seeks comment on what the benchmarks should be for identifying areas with costs that are either too low or too high to receive CAF Phase II support.²⁹ In order to ensure that broadband becomes accessible to the maximum number of unserved locations within the five years allotted for CAF Phase II, the Bureau asks how it can maximize the use of \$1.8

²⁷ Letter from Robert W. Quinn, Jr., AT&T, Steve Davis, CenturyLink, Michael T. Skrivan, FairPoint, Kathleen Q. Abernathy, Frontier, Kathleen Grillo, Verizon, and Michael D. Rhoda, Windstream, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 *et al.*, Attachment 3 at p. 18-19 (filed July 29, 2011) (“ABC Plan”); *see also* Letter from Jonathan Banks, USTelecom, to Marlene H. Dortch, Secretary, Federal Communications Commission, filed Feb. 13, 2012 (updating documentation of CQBAT model).

²⁸ Internal company estimates of broadband take rates in Puerto Rico indicate expected take rates between 20% and 30%.

²⁹ *Public Notice*, ¶¶ 64-71.

billion in support. The Bureau’s proposal of setting upper and lower boundaries of per-line costs will not facilitate the Commission’s goal of achieving 100 percent broadband coverage. In order to stay within the budget, the “supported range” will narrow. Currently, the supported range falls between \$80 and \$256. Narrowing the range will cause the lower benchmark to increase, making broadband less affordable for the high number of low-income consumers in Puerto Rico and certain other insular carriers, and will cause the upper benchmark to decrease, pushing more high cost areas into the Remote Areas Fund (“RAF”), which has a limited amount of funding that should be reserved for only the highest cost and most remote areas that also characterize the insular carriers. Consequently, consumers who need these services the most will not have access to distance learning, telemedicine, and merchant services that make them part of the world economy.

e. Data Inputs. The *Notice* seeks comment on a number of data source issues, as well as methods for validating data inputs.³⁰ PRT encourages the Bureau to seek further comment on data inputs once the model is designed. However, PRT believes that for insular carriers, where the homogeneity assumption is tenuous at best, carrier-specific inputs must be used in the model, or at least be the means of validating the model. For the same reasons that it does not make sense to base CAF Phase II support for PRT on a one-size-fits-all model, it also does not make sense that the inputs to any model that will be applied to Puerto Rico would be based on inputs that do not apply to the unique aspects of its service territory.

VI. Conclusion

Any cost model based on inputs from the U.S. mainland will not provide sufficient support to Puerto Rico for the deployment of broadband service in unserved areas. The cost

³⁰ *Id.* at ¶¶ 72-106.

model approach is deficient in that it assumes that high population density correlates with high subscribership rates, which is not the case the in Puerto Rico, and is unable to quantify the additional costs imposed by the Commission's legacy of underfunding wireline networks in Puerto Rico. In the absence of a cost model that addresses the unique and compelling needs of Puerto Rico and other insular areas, the Bureau should not include these insular areas in any cost model. In the alternative, and consistent with paragraph 193 of the *USF/ICC Order*, the Bureau should ensure that Puerto Rico is permitted to maintain its frozen legacy universal service support at least until such time as telephone and broadband penetration rates in Puerto Rico are on par with the rest of the nation. This approach is in the public interest, consistent with the plain terms of Section 254(b) of the Communications Act, and appropriate to ensure that Puerto Rico receives the transformational benefits engendered by ubiquitous broadband deployment.

Respectfully submitted,

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