



PUERTO RICO TELECOMUNICATIONS INDUSTRY ALLIANCE

**A simple proposal for the economic development in Puerto Rico:
The government as a facilitator instead of competitor against
private enterprise.**

Executive Summary

We wish to bring to the Task Force's attention that the Puerto Rico Electric Power Authority ("PREPA"), a local government entity, has squandered a significant amount of public funds, adversely affecting the people of Puerto Rico. We strongly urge action before the cost to public finances and taxpayers is worse than it already is.

Since the enactment of the Federal Telecommunications Act of 1996, both, technology and access to it have had an exponential increase. Puerto Rico Law 213 of 1996 regulates competition in our industry locally, in harmony with the federal Telecommunications Act of 1996.

The development of our society and our economy these past 18 years has been driven precisely by an industry in free competition in telecommunications. An industry that today boasts more than 60 vendors, carriers, relay antenna operators and other telecommunications technology service providers, scattered throughout the Island. Due to this healthy expansion, the government had not ventured into these services, except for the recent attempts from entities seeking to justify their existence at the expense of Puerto Rican taxpayers.

The Puerto Rico Office of Management and Budget (“OMB”) entered into a contract (#2015-000054) with Consolidated Telecom of Puerto Rico, LLC d/b/a Conso Tel of Puerto Rico d/b/a On Net Fiber Powered Networks (“OnNet”), a wholly-owned subsidiary of a PREPA-owned holding company, in order to provide telecommunication services to governmental agencies without publicly asking for proposals to all service providers. Not only was the contract entered into without competitive bids, but at special terms not offered to private enterprise telecommunications service providers. As has been demonstrated after the execution of this agreement, the real intention behind this potentially devastating practice was to cancel the contracts between private telecommunications service providers and the government of Puerto Rico to benefit OnNet, thus clearing the way for contracts between the government and PREPA entities for telecommunications services. This nefarious practice exacerbates PREPA’s and PRASA’s (Puerto Rico Aqueducts and Sewer Authority) financial crises, since one of their main assets are uncollectible accounts from state government agencies. We ask, if government agencies will hire PrepaNet/OnNet in order not to pay for their service, who will then pay for PrepaNet/OnNet’s operating expenses and how? Obviously, PREPA will pay for them and, therefore, the consumers will pay for them in our monthly electric bill and the bondholders will be asked to share in paying for this reckless activity.

It is important to remember that it was PREPA, with its default on its bond obligations, that started the chain of events that required the enactment of PROMESA. Now, at the same time it begs Congress to help with a mechanism to reorder its debt (i.e. not pay the bondholders the full amount owed), the government of Puerto Rico through a PREPA subsidiary is competing against private enterprise in direct contravention of the Sense of Congress stipulated in section S04(b)(3). They want to eat the pie and keep it too.

The Telecommunications Industry in Puerto Rico

Puerto Rico is one of the jurisdictions (including the continental US) with the lowest cellular phone cost at the consumer level around the world. In addition, this healthy and fair competition, especially in mobile telephony, has caused significant cultural changes on the Island. In 2003 there were 1,305,000 fixed lines - what we know as traditional fixed-line phones - and 1,709,000 active cellular numbers. Ten years later, in 2013, there were 660,838 fixed lines versus 3,085,000 active cellular numbers on the Island. That is, in a period of ten years, traditional phone lines were cut in half while cell phone numbers almost tripled. This cellular phone subscribership growth reflects, not only the convenience that they represent in terms of flexibility, movement and versatility over a landline phone, but it also reflects the very competitive price of cellular service and how consumers have moved to reduce their expenses.

In the area of Internet services, based on the most recent study of the firm Estudios Técnicos, Inc., in 2013 there were 1,808,154 access points to the Internet from computers; 57% of people over 12 years in our total population have access to the Internet. For this population, the level of "broadband penetration" is 99% (broadband Internet). Of these, 91% have personal pages on social networks. For the first time in Puerto Rico, the proportion of Internet users through mobile devices (70%) is greater than Internet users through computer fixed lines, representing 63% of Internet users. This success story would never have been possible without a market in free, healthy and fair competition.

According to the most recent (mid-2014) economic study by economist Gustavo Vélez on the Telecommunications Industry in Puerto Rico, its impact on the overall economy of the Island, and the effect that the government's entry as a provider would have on the current industry's health, tells us that, despite the current economic and fiscal crisis being experienced by Puerto Rico, the Telecommunications Industry has been able to expand its investment in infrastructure and market points, maintaining a constant creation of well-paying

jobs. While other sectors, such as Construction, have reduced by \$1.9 billion their investment in the economy, in the Telecommunications Industry we have invested more than \$4 billion in capital in physical and technological infrastructure over the past 6 years. Our industry has contributed an average of \$543 million annually in state and municipal taxes on corporate income, plus the contributions made individually by industry employees.

Each dollar that the Telecommunications Industry receives, invests and recirculates through its business, returns to the local economy with a direct increase of \$1.52, which becomes \$2.52 with the multiplier effect; an increase of over 150% percent growth in the overall economy of the Island. Our industry produces about \$3.75 billion annually, or 5.4% of the Puerto Rico Gross National Product (GNP) at current prices; and employs more than 9,752 employees, with an estimated payroll of more than \$91.3 billion annually that recirculate and have a multiplier effect on our Puerto Rican economy.

In 2012, the average salary of an employee in Puerto Rico was \$24,905.00 per year, while in the Telecommunications Industry the average salary of an employee was \$41,714.00 per year. Against this background of investment and lift from our industry, the economic study mentioned above expressed a strong recommendation, very relevant to the consideration that this Congressional Task Force carries today. The study says,

“...Therefore, the telecommunications industry in Puerto Rico is an essential and vital component for economic recovery. This industry continues to grow despite the economic downturn. The government should be a facilitator of growth for this industry, and not a competitor against it in any way.” (Gustavo Velez: *President and Founder of Economic Intelligence, Inc.* He earned his Bachelor and

*Master in Economics from the University of Puerto Rico,
Río Piedras Campus Magna Cum Laude.*

*In March 2006, he founded consulting firm Economic
Intelligence Inc. This company provides advice economical
for local and multinational organizations.)*

Given this situation, we cannot be silent or ignore the threat posed by the Puerto Rico Electric Power Authority looming over our success story in Puerto Rico.

The Threat: Unfair competition due to cross subsidies/High Prices

Recently, the Puerto Rico Office of Management and Budget ("OMB"), which is called by law to manage and control government spending, using as a justification the ill devised contract #2015-000054 between OGP and OnNet has started to replace all private enterprise telecommunications service providers of high quality and cost efficient telephony, data, Internet and other technical services to all government agencies with PrepaNet/OnNet, governmental entities owned by PREPA. They are undertaking an aggressive campaign of unfair government competition against private enterprise. That is a direct and stark violation of Section 504(b)(3) of PROMESA and must be stopped forthright.

The present threat stems from the government-owned subsidiary company known as PREPA Holdings, LLC, and better known as PrepaNet, LLC. This subsidiary was created by the Puerto Rico Energy Power Authority ("PREPA") and its operational retail arm is called Consolidated Telecom of Puerto Rico, LLC, better known as OnNet or ConsoTel, LLC, which claims to be a "private entity" to pose as a private sector provider. PrepaNet, OnNet, or ConsoTel, LLC, are all two (or three) levels down subsidiaries of PREPA, trying to do wholesale and retail telecommunications business. All three entities have the same Executive Director.

Notwithstanding its financial problems, PREPA and the state government have taken affirmative steps (further described below) to provide Internet service, and

soon potentially cellular and cable TV, and broadband interconnection, among other things.

The first of several key questions is, what sources of financing will PREPA be accessing to embark on this effort called PrepaNet/OnNet? The subsidiary does not generate sufficient funds from its present client base. Furthermore, with what money did PrepaNet/OnNet just complete the construction of a new building in the tourist area of Isla Verde at a cost of \$40 million? Add to that the fact that PrepaNet/OnNet recently bought five floors of a new building in the middle of the banking district in Hato Rey, for its executive offices at a cost of almost \$3 million more.

It seems clear to us that the funds are obtained through cleverly devised cross subsidies and inter-agency arrangements to the detriment of private enterprise fair competition.

PrepaNet/OnNet financial statements do not reflect the financial capability to acquire by themselves the properties that they have already bought, nor the ability to finance the acquisition of a new building. They have been able to do this only because PREPA has supported them financially, further compromising the delicate financial situation that the Authority is in with this senseless venture, trying to compete in an already competitive market already served by more than 60 companies, the vast majority of which are medium and small size businesses ("SMEs") providing local capital.

Fair competition is not just about all competitors paying taxes, it is also about competitors sustaining a similar business model and structure based on costs that include all charges and encumbrances that other competitors in an open market also have. That is what the Federal Telecommunications Act of 1996 dictates, known as a "level playing field". To allege that the government could tax the

subsidiary's profits to try to equate it to the cost structure of a business taxed by the state (as PrepaNet/OnNet have alleged), provokes an egregious inequality. In other words, to allow a competitor to compete in unequal conditions results in a distortion in the market and, in this case, an insurmountable one.

PrepaNet/OnNet, based on their government subsidized business structure reflect an artificial and dishonestly low cost structure that destroys all fair competition. Federal and state law, both, expressly prohibit cross-subsidization of non-competitive services (e.g. electricity generation) to competitive services, such as telecommunications. We respectfully submit that this needs to be addressed by the Congressional Task Force.

The State is specifically designed to serve the citizen regarding that, which, fundamentally, nobody else serves, no matter its costs. The state government should NOT to compete in what many already serve, based on highly competitive cost and prices. The Puerto Rico government is called upon expressly by PROMESA to be a facilitator, not a competitor against private industry.

It is daunting to see, as Puerto Rican entrepreneurs who are making Herculean efforts to push our Island forward, but also as American citizens who have to pay our monthly bills, how PREPA collapses in front of our eyes. Meanwhile, our local government continues to threaten a vital sector of the Puerto Rican economy by competing against private enterprise.

The Threat: Infrastructure Duplication/Funds Waste

As we speak to you, telecommunications are being nationalized in Puerto Rico. The government is canceling one by one all contracts for telecommunications services with all private service providers, only to start the service being offered by PrepaNet/OnNet, using as a subterfuge a recent Executive Order signed by the Governor and a letter from the OMB's Director. At the same time, they have allowed and even encouraged OnNet to start building the infrastructure for fiber

and cabling for each of the first 55 agencies participating in the OMB project. These actions inexplicably disregard that all these agencies have had the required infrastructure for years already, built by the private sector to provide the same services.

The government is wasting money from the people of Puerto Rico, building what has already been built. And to that effect, OMB signed a multimillion-dollar contract last June 11, 2015, of which it advanced \$600,000 to OnNet for completion of the infrastructure to provide the service. Unbelievably, OMB advanced cash to OnNet to provide a service to the agencies, which was already being provided by the private enterprise.

Although OMB is advancing public funds to this agency, we know that that amount is not even enough to begin the project, which by our estimates would cost a total of \$100 million in five years, after reaching 100% of the government agencies. We fear that all this effort seeks to address OMB's cash flow shortfall in the short term. However, even if that were the case, someone has to pay for that operation. OnNet employees have to charge and collect for services being offered, and the company has to pay business obligations. The inescapable conclusion is that the money will come out of every Puerto Rican's pocket every month when they pay their electric bill or through other cross-government subsidies.

The Threat: Investor Reluctance

The facts related above show the callousness with which PrepaNet/OnNet do what they want, handing the bill to the consumer, without a reason other than to purely and simply justify their existence. This has consequences that extend beyond the telecommunications industry. Through ignorance or design, Puerto Rico is giving a grim example to foreign investors evaluating potential this Puerto Rico. They will see how the government, rather than being a facilitator of, is a competitor against the private sector. They will see a government that waits for private capital investment and, once it sees the investors' success, it seizes the opportunity that

that investment yields. These investors will watch as the government becomes an animal that eats its young, and therefore decide to invest their capital in other places where there is no toxic investment environment. We warn that the consequences of this gross recklessness, joins others from PREPA and its subsidiaries, which affect the future of all of the American Citizens in Puerto Rico.

The Threat: Risk of Further Economic Contraction on the Island

A study by Economic Intelligence, Inc., a renowned Puerto Rican firm that conducted an analysis in Puerto Rico, and collected corroborated data from the entire local industry, the Planning Board, the Department of Labor and other reliable entities to ensure the quality of their study; presented very revealing data. Assuming three scenarios related to the entry to the local market of Prepanet/OnNet, offering all the retail services that they are already starting to offer, the results are devastating for the Puerto Rican economy:

- Assuming a scenario where PrepaNet/OnNet have a 10% share of the market (which has already begun with the help of OMB), the industry's production would start losing \$947 million a year that would not circulate in the Island's economy, leaving about 1,648 families without employment, and reducing its payroll by \$13 million annually that would stop recirculating in our economy.
- In a scenario where PrepaNet/OnNet have a 30% share of the market, of the industry's production would decrease by \$2.84 million annually that would not circulate in the Island's economy, leaving about 4,944 families without employment, and reducing its payroll by \$38 million annually that would stop recirculating in our economy.
- In a scenario where PrepaNet/OnNet have a 50% share of the market, production industry would lose \$4.73 million annually that would not circulate in the Island's economy, leaving about 8,240 families without employment, and reducing its payroll by \$64 million annually that would stop

recirculating in our economy. This third scenario would lead to the virtual disappearance of Telecommunications Industry of Puerto Rico.

As you may see, there is not a single positive scenario if PrepaNet/OnNet makes an industry incursion. The reason is found in a basic principle of modern economics: the government does not produce new money; the government only recirculates the existing money, without growth. Only private enterprises of new money entering the economy through investment, including capital investment in infrastructure and technology; expansions that bring new payroll and employees; in opening new domestic and foreign markets that allow export, and thus a internal growth related to such exports. All this can be produced by the private sector of the economy, but not by the government sector, by design. This is why the entrance of the government, in this case PREPA's entities, in the open market and free competition in telecommunications only produce an even sharper contraction of our fragile economy.

The Threat: Risk of Reducing Creation of New Telecommunications Companies

This unfair competition from PrepaNet/OnNet, is not only affecting the telecommunications companies, but is reducing the creation of new ones. We estimate that with a growing PrepaNet/OnNet penetration, if it's not stopped in time, we will continue to lose more customers and our ability to compete will disappear, the same as our companies.

At present there are more than 60 small telecommunications companies that are competing in the market and bringing services to areas where many larger companies fail. We know of companies in mountain villages and all around Puerto Rico who are providing quality services and at the same time create jobs in their municipalities. They are SMEs that are creating local jobs in these towns and are filling a gap where large telecommunications companies find it costly to provide service. These small businesses use their imagination and through local business

relationships in small towns they provide quality service. Government-subsidized PrepaNet may enter and compete with them using these mechanisms of unfair competition, which ultimately have the effect of destroying the SMEs as an engine of the economic structure.

We should not forget either that there is a whole ecosystem of small companies serving the large ones. We all know that SMEs are an important part of the engine of the economy. In an industry where employees earn the highest salary in Puerto Rico, those jobs need to be preserved. Even more so if Puerto Rico is stimulate the engine of economic development.

Our message to the Congressional Task Force is specific and clear: allowing the existence of a public company that competes in unequal terms, endangers a telecommunications vibrant industry that, not only has big names like America Móvil/CLARO, AT&T, Liberty, Columbus, WorldNet, but also many small ones, such as VPnet, AeroNet, Neptuno, DataAcces, Optivon, and many others who create jobs today.

In summary, the solution is not to keep throwing debt at the current crisis that we live every day in Puerto Rico. If PREPA continues to walk down the path they have chosen, they will be successful at indebting us all. They government should leave making investments in the telecommunications industry to those who have the expertise to do so, and focus its efforts in the areas of essential services that the government is supposed to be serving. Government entities should not asked, in this time of great fiscal fragility, to make unnecessary investments in an industry where the private sector is fulfilling the needs of the public by offering high quality services at the lowest prices in the world. They should be making relevant telecommunications infrastructure that they own available to private companies in exchange for fees in order to receive income for their respective government entities without incurring in additional charges for it. The government does not need to start a business in order to receive income. To have revenue opportunities,

the government only needs to rent at the wholesale level their existing telecommunications facilities and infrastructure to companies duly certified to provide the service. Obviously, this is not the same as trying to compete in an open and already widely served market at the retail level.

The Puerto Rico Telecommunications Alliance believes that the best path to achieve fair and balanced competition resulting in lower prices, better technology and improved access for citizens, is for the government to play the role of facilitator, instead of incurring in unfair competition practices with resources sorely needed to tend to Puerto Rico's fiscal crisis. The telecommunications industry has time and again proven that it can offer very high quality service at very low prices.

Precisely to protect against this problem, Congress included language in PROMESA that reflects the public policy that the Puerto Rico government should follow in order to prevent the government, itself, from hindering the economic development of the island.

In Public Law 114-187 on 6/30/2016 "Puerto Rico Oversight, Management, and Economic Stability Act" or "PROMESA", the Congress tells us the following:

In SEC. 204. REVIEW OF ACTIVITIES TO ENSURE COMPLIANCE WITH FISCAL PLAN.

(a)...

(b)(1)...

(2) AUTHORITY TO REVIEW CERTAIN CONTRACTS.—The Oversight Board may establish policies to require prior Oversight Board approval of certain contracts, including leases and contracts to a governmental entity or government-owned corporations rather than private enterprises that are proposed to be executed by the territorial government, to ensure such proposed contracts promote market competition and are not inconsistent with the approved Fiscal Plan.

(3) SENSE OF CONGRESS.—It is the sense of Congress that any policies established by the Oversight Board pursuant to paragraph (2) should be designed to make the government contracting process more effective, to increase the public’s faith in this process, to make appropriate use of the Oversight Board’s time and resources, to make the territorial government a facilitator and not a competitor to private enterprise, and to avoid creating any additional bureaucratic obstacles to efficient contracting.

(4)...

In SEC. 205. RECOMMENDATIONS ON FINANCIAL STABILITY AND MANAGEMENT RESPONSIBILITY.

(a) (1)...

(10) the privatization and commercialization of entities within the territorial government.

(b)...

Notwithstanding the foregoing, the Governor of Puerto Rico, in clear violation of this Congressional mandate, chose to veto Senate Bill 1370 (“PS 1370”, a local law which was approved by 88% of State Legislators of both political parties), which dealt with PrepaNet/OnNet negative impact on telecommunications and solved their illegal and contrary to economic development participation in the market. Although Congressmen Rep. Jody B. Hice (REP-GA) and Rep. Pedro Pierluisi (DEM-PR) wrote letters to the Governor reminding him of the express mandate of Congress in PROMESA and urging him to sign and enact into law PS1370, Governor Garcia Padilla chose to challenge and ignore federal law and vetoed PS 1370, letting PrepaNet/OnNet continue the waste of public funds and hindering telecommunications and technology economic development on the Island.

We therefore believe that it is our duty at this time to draw the attention and commitment of the Congressional Task Force to tend to and deal with this issue before still more damage is done to Puerto Rico’s economy.

Conclusion

The Puerto Rico Telecommunications Alliance believes that it is essential that this Congressional Task Force understand the seriousness regarding the distortion in the market of telecommunications, information services and television in Puerto Rico, which would result from the government insisting on re-venturing into that market in direct, unfair and dishonest competition against the private industry. The government should be a facilitator, not a competitor. That is the public policy recently underscored in Public Law 114-187 on 6/30/2016, Sec. 204(b)(2)(3) and Sec. 205 (a)(10), known as PROMESA.

In conclusion, we can see how our Island has evolved over the last 20 years hand in hand with a vigorous private telecommunication industry, committed to providing better services at lower prices. As a result of this scenario, the Puerto Rican consumer has benefited from being exposed to fair and healthy competition in products, services and prices.

This scenario could be totally distorted and fail if the government tried to re-enter a market that ceased to be a monopoly 20 years ago. Therefore, we hope that this Congressional Task Force will exercise all its prerogatives with the urgency that we understand this warrants, and will recommend the application of PROMESA, eliminating this government subsidized PrepaNet/OnNet business. Action is urgently needed so that we can stop the Island's economic bleeding and focus scarce government resources towards the benefit of the future of the people of Puerto Rico.

For the reasons stated above, the Puerto Rico Telecommunications Industry Alliance **requests that the Congressional Task Force include in its Recommendations for the Economic Development of Puerto Rico, the necessary steps to stop the government of Puerto Rico from competing against private enterprise, starting with the case of PREPA, and become a**

facilitator of private enterprise telecommunications businesses to expand their investment in Puerto Rico, creating more jobs and moving forward our economy. In order to be able to achieve the objective of growth of the Puerto Rico economy, we call for the enforcement of sections 204(b)(2)(3) and section 205 (a)(10) of Public Law 114-187. **We further request that the Task Force inform the Financial Oversight and Management Board, and all congressional committees with jurisdiction on this matter, of the egregious violation of the Sense of Congress presently occurring by the competition against private enterprise being undertaken by the government of Puerto Rico and the urgent need to stop the destruction of one of Puerto Rico's largest private sectors.**