McLean & Brown

ISSUE UPDATE

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FCC Issues Rural Universal Service Order

On May 23, 2001 the FCC released the text of its Order on the new universal service support plan for rural LECs. The Order is titled ***Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket 96-45, and Report and Order in CC Docket No. 00-256.*** The Order consist of 99 pages plus attachments. Following is a summary of the Order :

I. General

- The Commission adopted a new rural universal service plan for a 5-year period that generally follows the recommendations of the Rural Task Force (RTF), with some modifications.
- The Commission accepted the recommendation of the Universal Service Joint Board that they take advantage of the consensus reached by the diverse interests represented on the RTF.
- The high-cost fund for rural carriers will continue to be based upon embedded costs for the next five years.
  - While this fund will continue to be capped, it will be "re-based" by computing the fund size as though caps had not been in effect for calendar year 2000. It will then be grown annually by a "Rural Growth Factor".
  - The Commission estimates this Order will increase funding for rural carriers by $1.26B over its 5-year term.
  - The cap on corporate operations expenses will be increased to account for past inflation, and allows a higher level of expenses for smaller carriers than under the prior cap.
  - The plan provides "Safety Net" support for carriers that make significant incremental investment, and "Safety Valve" support to provide a limited amount of support for exchanges acquired from other carriers.
  - Carriers are provided the option to disaggregate and target study area support below the wire center level.
- A wireless CETC customer's location for purposes of determining support will be that customer's billing address.
- The Commission specifically indicates that this 5-year plan will be "interim" and that it intends to adopt a permanent plan for rural carriers based upon forward-looking cost.

II. The Modified Embedded Cost Mechanism

- **Indexed Cap and Rural Growth Factor**
  - The new base level for the high-cost loop fund will be computed under the current formulas as though neither the indexed cap nor the corporate operations expense limitation had been in effect for calendar year 2000. In subsequent years this cap will be grown by the Rural Growth Factor (RGF).
  - The RGF will be composed of inflation (GDP-CPI) plus the growth in rural carrier working loops.
  - The Commission declines to include a productivity factor in this calculation although they indicate that
  - "…rural carriers have experienced modest productivity gains over time".
  - The National Average Loop Cost will be frozen at $240 for purposes of computing rural high-cost loop support. Non-rural carries will be relieved of the obligation to file loop cost data on a quarterly basis.
  - The overall size of the rural high-cost loop fund will be reduced to reflect the removal of support for access lines transferred from rural carriers to non-rural carriers or to other rural carriers. Also, all lines transferred to rural carriers will be excluded from the line count. Both of these adjustments are necessary since support for transferred exchanges is handled outside of the cap.
- **Corporate Operations Expenses**
  - The Commission raises the minimum cap of corporate operations expenses for carriers with less than 6,000 loops from $300,000 to $600,000 or actual expenses, whichever is less.
  - The dollar values in the corporate operations expense limitation formula will be increased for past inflation, and will be adjusted annually for inflation going forward.

II. Support Above the Cap

- **Safety Net Additive**
  - Carriers will be eligible for additional support in years when their telecommunications plant in service (TPIS) grows more than 14% over the prior year's level, and when the overall fund size is subject to a cap.
  - Carriers that qualify for Safety Net Support must provide written notice to the Commission and USAC in conjunction with their annual or quarterly submissions to NECA.

- The Safety Net Support effectively provides full support for all new investment in the year that a carrier qualifies.

  $SNS_q = (US_q - US_b) - (CS_q - CS_b)$

  Where:
  SNS_q = Safety net support in the qualifying year
  US_q = Uncapped support in the qualifying year
  US_b = Uncapped support in the base year
  CS_q = Capped support in the qualifying year
  CS_b = Capped support in the base year

  The first term in parenthesis reflects the amount of uncapped support for the new investment, while the second represents the support that would be provided for that investment under the cap. The difference, or Safety Nets support, represents the amount necessary to bring support for the new investment up to the uncapped level.

- Once a carrier qualifies for Safety Net Support they will receive this support in subsequent years of the 5-year plan whether or not they meet the 14% TPIS trigger in those years.
- Safety Net support should be portable to competitive ETCs.

· **M&A Cap and the Safety Valve Mechanism**
  - Section 54.305 should be retained, but additional support should be provided to rural carriers that make substantial investment after acquiring exchanges. Under 54.305, the acquiring carrier was limited to the support that would have been received by the selling carrier.
  - Carriers will generally receive 50% of the difference between the support the area would otherwise qualify for at the end of the first year of operations by the new carrier (the index year), and the support the area would qualify for in any subsequent year. This difference in support requirements beyond the first year is assumed to be due to new investment.
  - Carriers may establish the index year for determining future Safety Valve support earlier by choosing to file quarterly expense reports rather than annual reports. Carriers must provide written notice to USAC of when their index year has been established.
  - Under no circumstances shall a rural carrier receive more support through transferred support and the Safety Valve mechanism than it would otherwise receive in uncapped high-cost loop support.
  - Carriers that receive Safety Valve support are not eligible to receive Safety Net support.
  - The total amount of safety valve support for all carriers is limited to no more than 5% of the rural high-cost loop fund. The Commission believes that it is unlikely that demand for Safety Valve support will exceed this 5% cap.
  - Safety Valve support should be portable to competitive ETCs.
  - Above-the-cap support, such as the Safety Net and Safety Valve mechanisms should not transfer with acquired exchanges. Acquiring carriers would be required to establish their own index year and receive support only for new investment.

· **Support in Study Areas with CETCs**
  - The Commission rejects the RTF proposal that high-cost support per loop be frozen when a CETC initiates service in a rural carrier's study area.
  - Rural carriers will be required to file line count data on a quarterly basis upon competitive entry in their study area.
  - The FCC seeks comment in an FNPRM on alternative measures to address the potential impact of excessive growth in the fund as a result of an incumbent's loss of lines to a CETC.
    - Specifically, the Commission requests comment on whether support should be frozen only when the CETC serves a specific percentage of lines within a study area.
    - Comment is also sought on whether support should be frozen for the study area, the competitor's service area, or the incumbent's specific disaggregation zone.

III. Disaggregation and Targeting of Support

· **General Provisions**
  - The Commission approves, with some modifications, the three "Path" approach recommended by the RTF:
    - Path 1 – No disaggregation of support,
    - Path 2 – State Commission review and approval of disaggregation plan,
    - Path 3 – Self-certification of disaggregation plan.
  - Support should be disaggregated and targeted below the study area level so that support will be distributed in a manner that ensures that the per-line level of support is more closely associated with the cost of providing service.
  - All rural carriers must elect one of the three paths within 270 days of the new rules becoming effective (which will occur when the new rules are published in the Federal Register).
  - There is no "one size fits all" solution.

· **Path 1 – No Disaggregation**
  - To minimize the risk of "gaming", a carrier electing Path 1 must remain on this path until a state commission requires, on its own motion, or upon petition by an interested party, including the affected incumbent, a change to a different disaggregation and targeting methodology.
  - Other parties may request a state commission to require disaggregation of support, and states should be guided by the FCC's view that support should generally be disaggregated and targeted in a manner that the per-line level of support is more closely aligned with the cost of providing service.

· **Path 2 – State Approved Plan**
  - Provides utmost flexibility but requires regulatory approval to ensure that the methodology is competitively neutral.

· **Path 3 – Self Certification**
  - Rural carriers may disaggregate up to 2 cost zones per wire center, or file a plan that complies with a prior state approved plan.
  - The plan must meet the following requirements:
    - Total support from the disaggregated zones must equal the total study area support.
    - Relative per-line support relationships between zones should remain fixed over time, and such relationships should be made public.

- Support will be provided on a study area averaged basis until a CETC enters the area.
- Carriers must provide USAC with zone maps, and with publicly available information that allows competitors to verify and reproduce the algorithm used to determine zone support levels.
- In study areas in which a CETC has been designated prior to the effective date of these rules, Path 3 is only available to the extent that a disaggregation plan has already been approved by the state. Otherwise, carriers must file under Path 2.
- Path 3 filings are subject to complaint by interested parties on the grounds that they do not comply with the self-certification requirements.

_ Once an incumbent elects Path 3 the plan shall remain in effect until the state commission requires, on its own motion, or upon petition by an interested party, including the affected incumbent, a change to a different disaggregation and targeting methodology.

Live Web Briefing

To effectively manage in the new environment created by this Order, telcom players must have the ability to understand and analyze their service territory in ways that they have never done before. Portability of support, and the opportunity (or requirement) to disaggregate support below the study area and wire center level will place a premium on the understanding and effective analysis of the various disaggregation paths and options available.

To assist companies with this important process, McLean & Brown (M&B), in partnership with CCG Consulting, Inc., has developed a powerful Universal Service Impact Analysis (USIA) tool. This tool incorporates demographic, cost and market data bases with sophisticated mapping functionality to provide users with the ability to visualize and analyze their disaggregation options under the new rules and develop an optimal strategy for each of their study areas. M&B and CCG currently have the ability to provide USIA analysis studies for any study area in the United States. These studies will provide maps, data and analysis of various disaggregation scenarios down to the individual wire center level.

M&B and CCG will host web meetings on June 13 and 14, 2001 during which we will provide an overview and briefing on the FCC's Rural Universal Service Order, and demonstrate the USIA tool. The session will begin on Wednesday June 13 at 2pm EDT, and on Thursday June 14 at 11am EDT. Both briefings will last approximately one hour, and there is no charge to participate. **Port space for these web briefings is limited, so reserve yours now**. Contact usia@c-c-g.com to get more details.

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