Universal Service Fund (USF) and Intercarrier Compensation (ICC) Reform in Turmoil

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USF and ICC Provide the Majority of RLEC Revenues and make "Universal Service" Possible

Source of Revenues		
Source	**Rural**	**RBOC**
End User	27%	61%
Access Charges	26%	10%
USF	30%	0%
Other	17%	29%

Both Programs Face <u>Serious Challenges</u>

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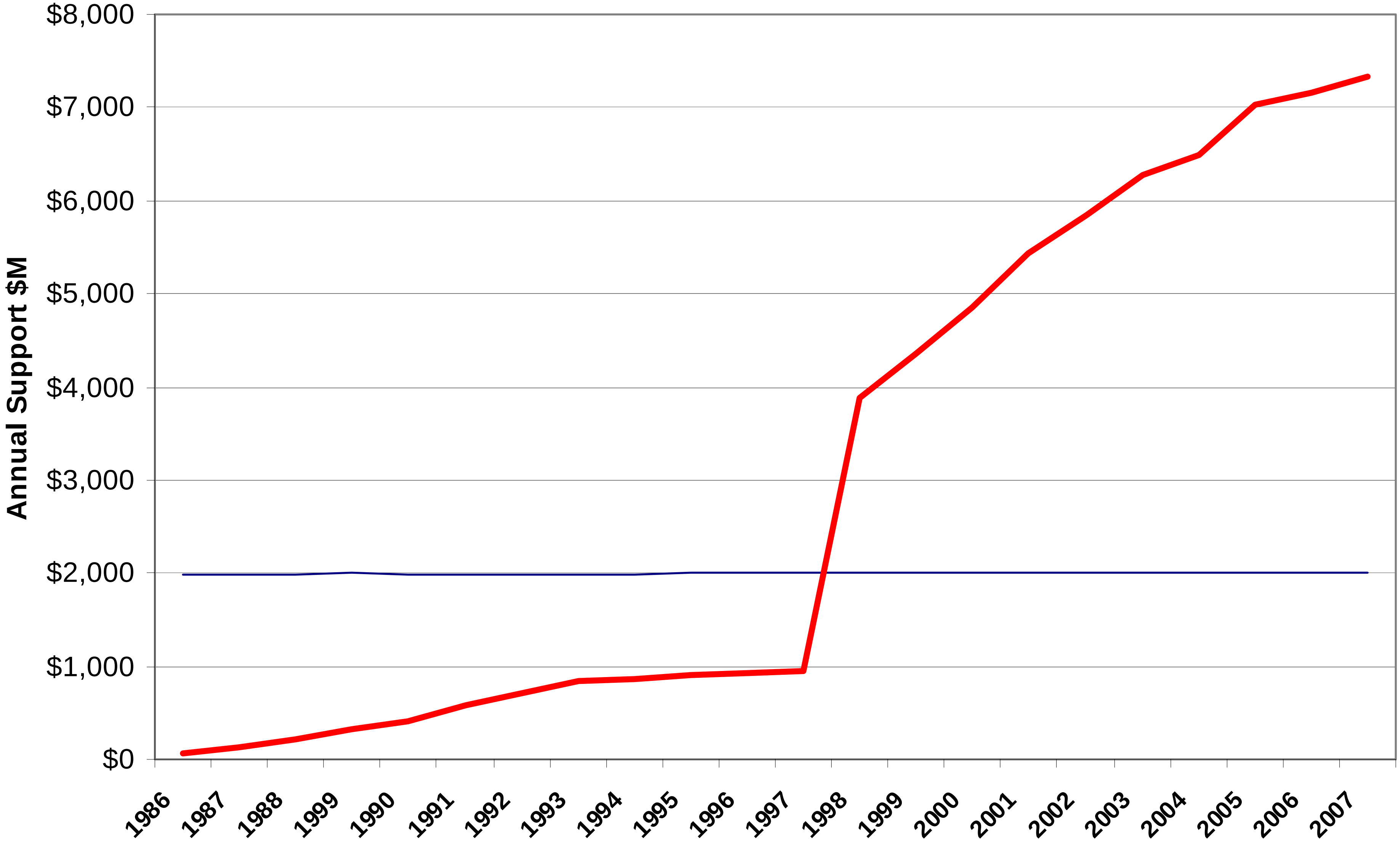
Growth in the USF



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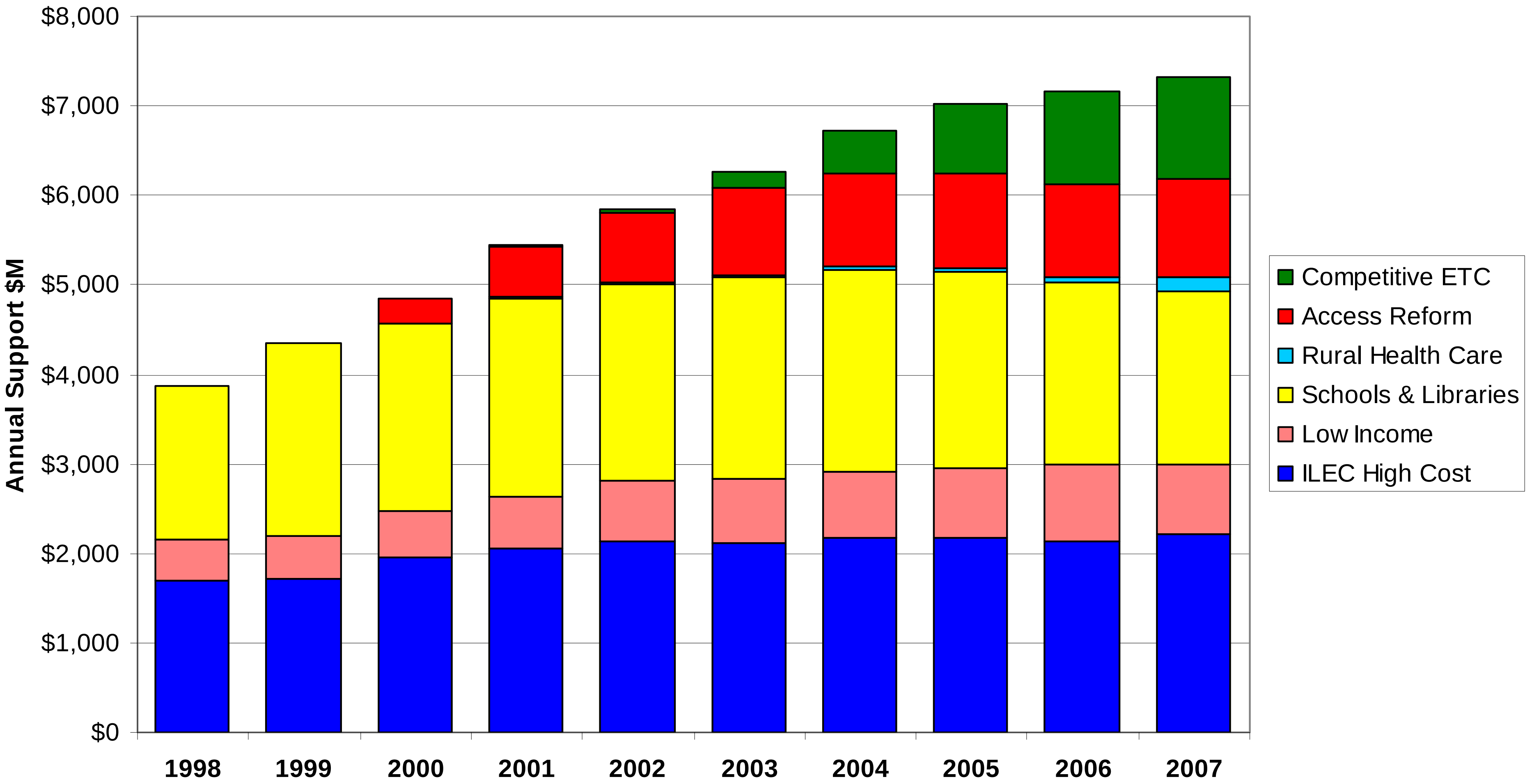
Recent Growth Has Been Due to CETCs



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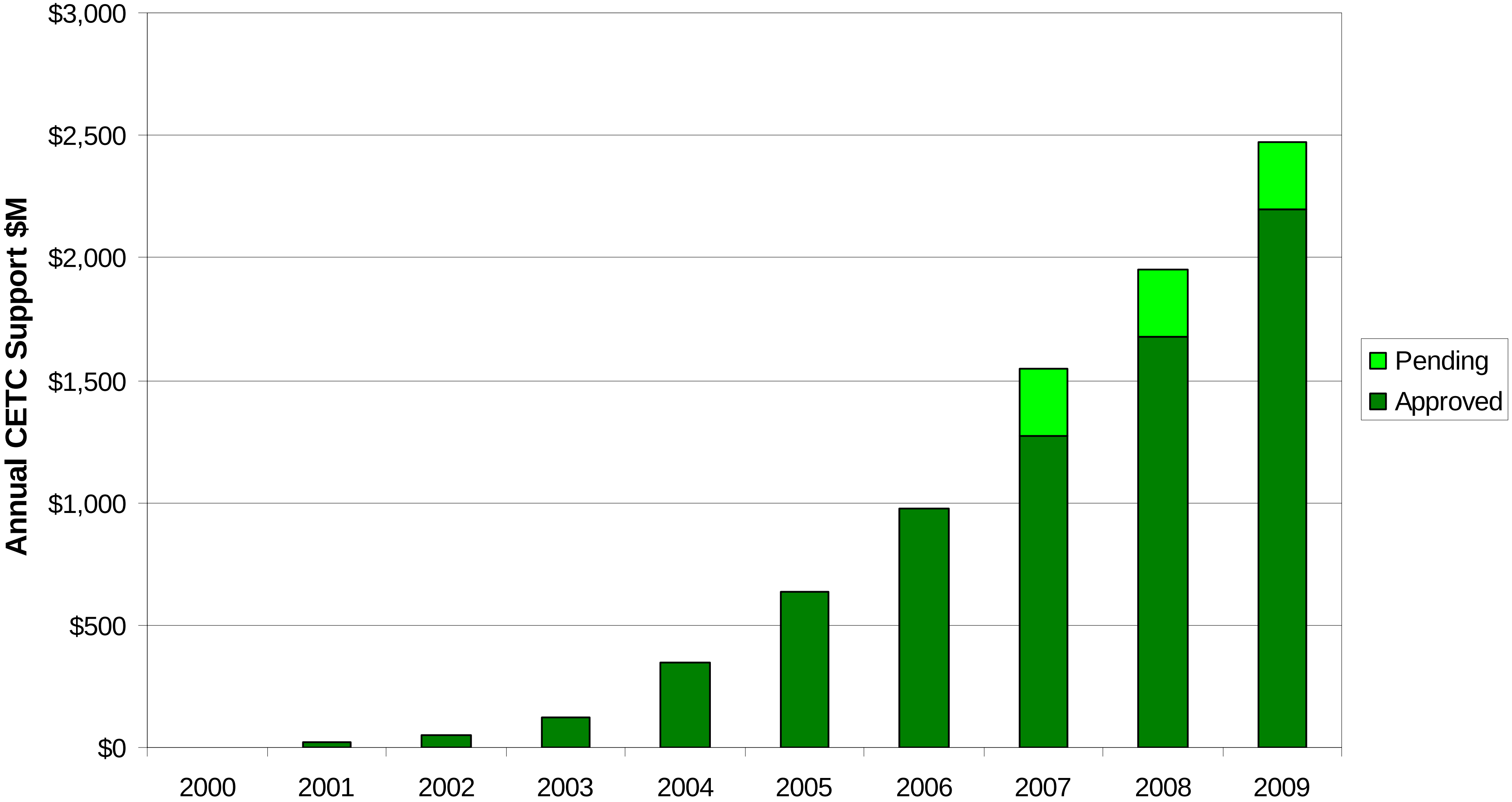
Change in CETC Funding is Needed



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Major Milestones

- **May 14, 2007 – Joint Board recommends an interim, emergency cap on funding to CETCs**
- **November 20, 2007 – Joint Board recommends:**
  - Cap overall size of the High-Cost Fund
  - Split the fund into three separate funds
    1. Provider of Last Resort (POLR)
    2. Broadband
    3. Wireless
  - Eliminate the Identical Support Rule
  - Reverse Auctions may offer advantages and should be further explored

Challenges to USF

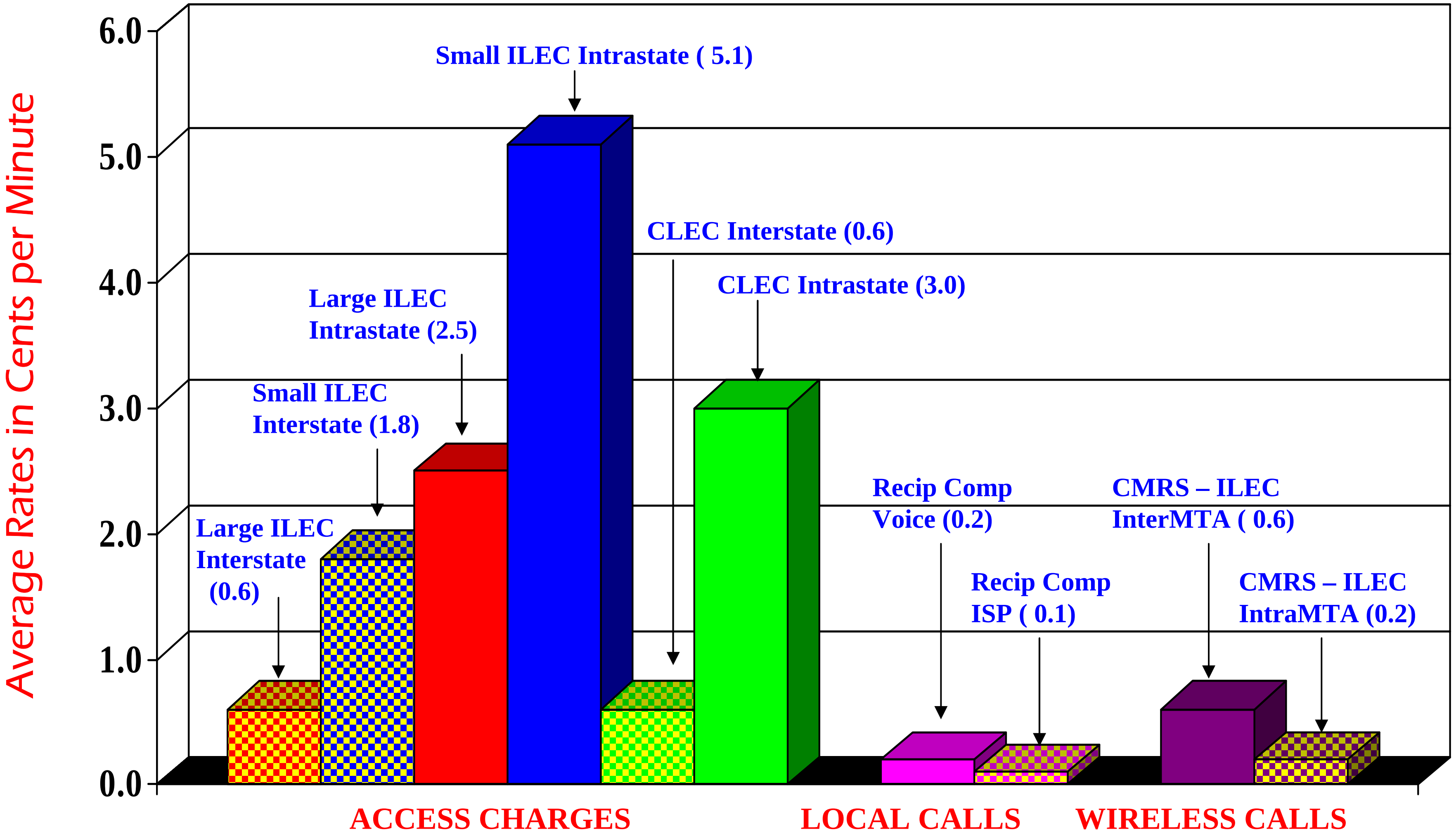
1. **Political pressure to cap or reduce the size of the fund**
2. **USF Contribution Mechanism**
3. **Funding to Competitive ETCs**
4. **Reverse Auctions**
5. **Broadband**
   - Should it be included in USF?
   - Should 100% broadband availability be required?
   - Will additional funding be available?
6. **Audits**

Intercarrier Compensation and the Universal Service Fund are Really Two Sides of the Same Coin

ICC Reform is Badly Needed

- **Disparate charging mechanisms for handling traffic**
  - Jurisdiction
  - Nature of call
  - Type of carrier
- **System is neither economically rational nor sustainable**
  - Opportunity for arbitrage
  - Phantom traffic
  - Traffic identification problems
- **The shift to a broadband environment undermines a fundamental source of revenues used to support the costs of the current network**
  - Access revenues will not be sustainable in an IP and broadband environment
  - Without access revenues, companies will need another revenue source to cover costs
  - Without reform, companies may be unable to pay the debt on existing infrastructure and unable to deploy the next generation infrastructure

The Current ICC System is Broken



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History of ICC "Reform"

- **2001 – FCC releases NOI suggesting "Bill & Keep"**
- **2003 – ICF formed to support adoption of Bill & Keep**
- **2004 – RLECs form two groups to address ICC reform**
  - ARIC and EPG
- **2004 – NARUC forms Intercarrier Compensation Task Force**
- **2005 – RLEC groups unite to form the Rural Alliance**
- **2006 – ICC Task Force produces the "Missoula Plan"**
- **2008 – Court establishes Nov 5 date for ICC Reform (CORE)**
- **2008 – FCC implements interim CETC USF cap**
- **2008 – FCC asks parties to "refresh the record" on ICC reform**
  - Verizon, AT&T, et. al. propose uniform $0.0007 ICC rate
  - FCC Chairman Martin circulates comprehensive ICC and USF plan
  - FCC Commissioners do not reach agreement on Nov 5

Rural Alliance Critical Goals

1. **Multi-track approach that recognizes the unique needs of rural RoR carriers and their customers**
2. **ICC rates must be cost-based**
3. **There must be a sustainable and non-portable Restructure Mechanism (RM) to replace ICC revenues lost as a result of reform**
4. **RLECs cannot be financially responsible for the transport of traffic beyond their networks**

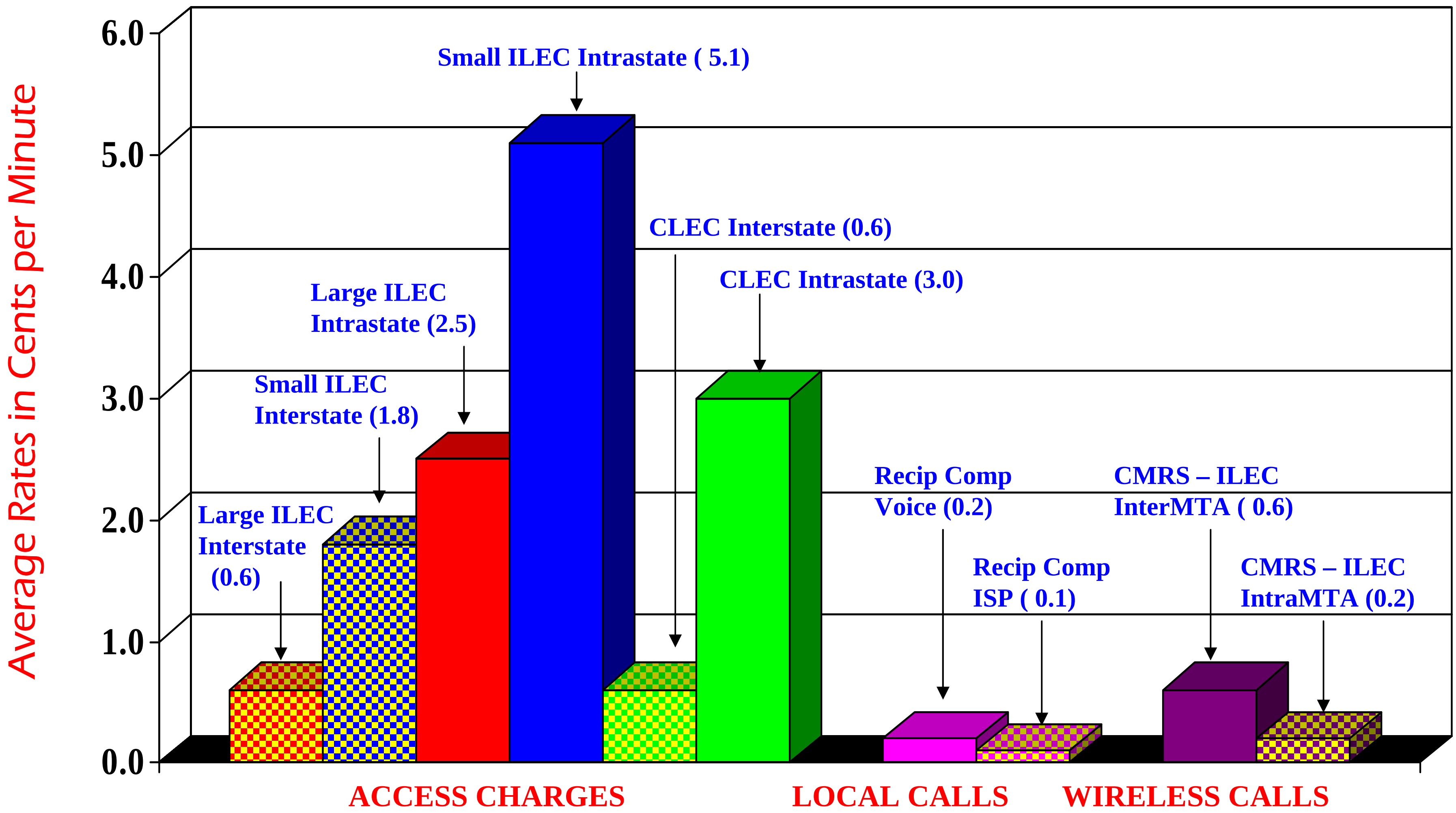
The Missoula Plan met all of these critical goals

-- But it never went anywhere

Major Components of Missoula Plan

- **Three “Tracks”**
  - Track 1 – Large Price Cap Carriers
  - Track 2 – Mid-Size Carriers
  - Track 3 – Small RoR Carriers
- **Track 3 carriers unify ICC rates a interstate levels**
- **A Restructure Mechanism (RM) replaces ICC revenue losses after a $2.25 SLC increase**
- **Comprehensive “Phantom Traffic” solution**
- **The Rural Transport Rule limits obligations of RLECs for the transport of traffic beyond their network boundaries**

The Missoula Plan Replaced This...



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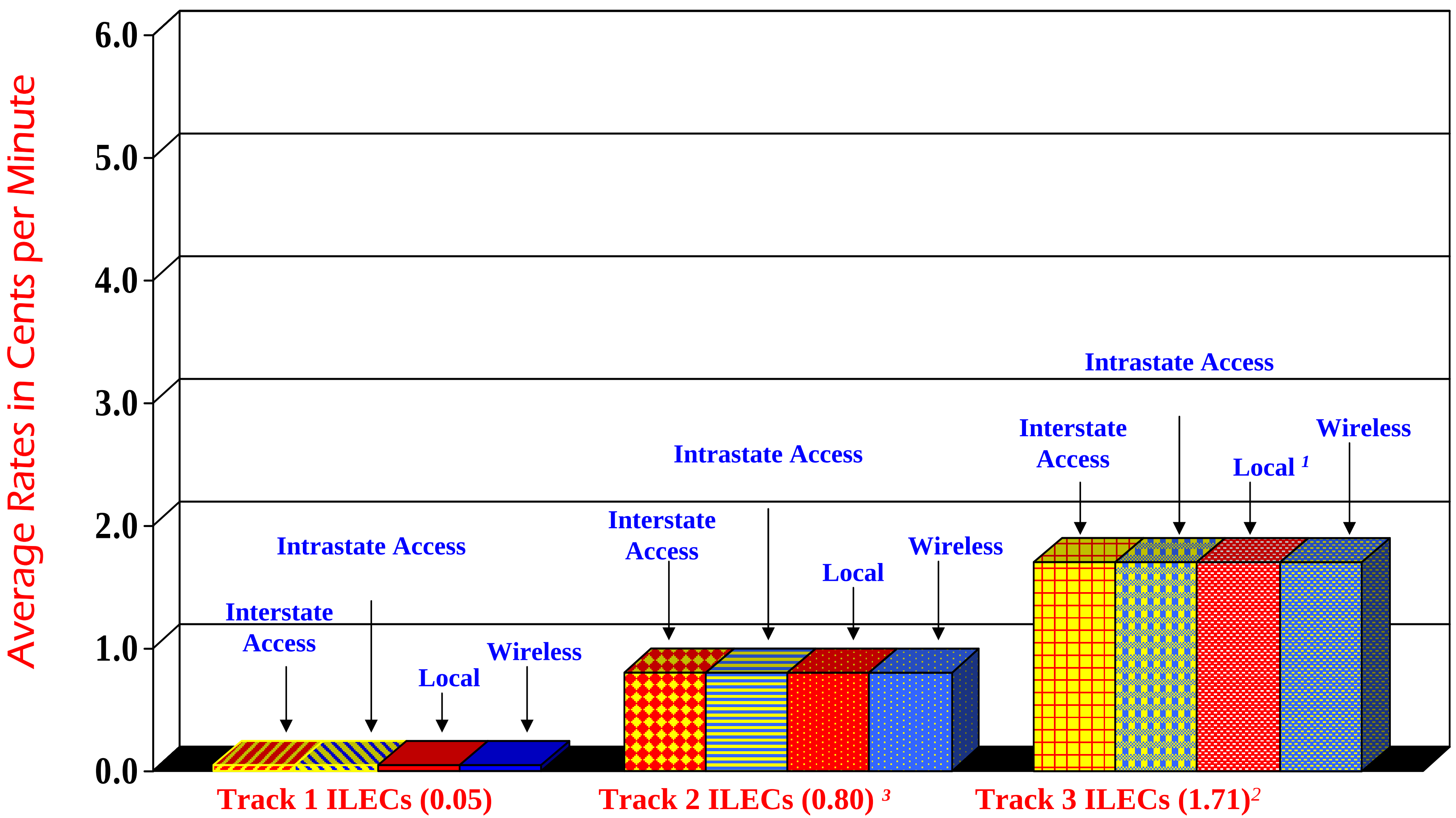
With This...



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Challenges to ICC

- **Should IP-based services be given a free ride on the PSTN?**
- **What standards for call labeling should be established to address “phantom traffic” and ensure appropriate compensation?**
- **Should ILECs be able to establish cost-based ICC rates?**
- **Should ICC rates distinguish between access and recip. comp. traffic (i.e., does originating access apply)?**
- **Should RoR ILECs be able to recover lost revenues through a sustainable Restructure Mechanism?**
- **As more traffic migrates to the Broadband/IP alternatives, how will “revenue neutrality” be determined?**

Is there a uniform $0.0007 rate in our future?

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On Nov 5 the FCC Released an Order

- **Midnight release - 430 pages in length!!**
- **Addressed ISP-Bound Traffic issue by perpetuating the prior belief that this traffic was somehow different**
- **Rejected the Joint Board Recommended Decision on USF reform**
- **Three attachments with vastly different policy prescriptions**
  A. Chairman Martin's "Comprehensive Solution"
  B. "Stand-Alone" USF Solution
  C. "Alternative Proposal" amended in response to ex-partes
    - OPASTCO and WTA
    - CTIA
    - Free Press
- **Dueling press releases**
  - Copps, Adelstein, Tate & McDowell – Areas of Consensus
  - Martin – Why consensus may not be possible by Dec 18

Martin's "Comprehensive Solution"

ICC Reform

- All Access falls under 251(b)(5) Reciprocal Compensation standard
- Each state transitions to uniform terminating rate based on "forward-looking" cost over 10 years
- "Additional Cost" replaces TELRIC ($0.0007 → $0.00001)
- RoR carriers "made whole" for access losses after SLC Cap increases
- Price Cap carriers receive funding only upon complete showing of costs and revenues (including unregulated revenues)
- Phantom Traffic – For unidentified traffic, ILEC can charge highest ICC rate to the carrier from which traffic is received
- VoIP is an "information service" and does not pay access or recip comp

Martin's "Comprehensive Solution"
(continued)

USF Reform

- **High-Cost support frozen at 2008 levels**
- **Carrier must commit to 100% broadband coverage within 5 yrs**
  - If ILEC does not commit or achieve, area subject to reverse auction
  - If no other carrier bids, ILEC can get additional support
  - Limited use of satellite to achieve 100% coverage
- **Wireless ETC support capped at $1.2B**
  - Incumbents must submit cost support to justify need
  - Must make a 100% broadband commitment or area subject to reverse auction
- **USF Contribution moved to a "telephone numbers" basis**

Martin’s Alternative Stand-Alone USF Plan

- USF limited to voice services
- Cap on the overall size of the High-Cost USF fund
- Reverse auctions held periodically for each “geographic area” to select a single Provider of Last Resort (POLR)
- “Reserve Price” set a current funding level to prevent growth of the fund
- Geographic areas for auction would not be current Study Areas, but the “smallest geographic areas needing support” (Wire Centers?)
- USF Contribution moved to a “telephone numbers” basis

Ex-Parte Modifications

OPASTCO and WTA

- **The RM is automatically available to carriers under R0R regulation in the interstate jurisdiction**
- **The RM for rural RoR ILECs has two components**
  1. All RLEC revenues lost as a result of ICC rate reductions
  2. If the RLEC commits to the five-year build-out requirement, to insure the opportunity to earn authorized interstate RoR, subject to a cap

– **The Rural Transport Rule limits obligation of RLECs to transport traffic beyond their networks**

– **RLECs may serve very high-cost loops (>150% of study area average) by satellite without filing a waiver request**

– **High-cost support frozen at 2010 levels**

Ex-Parte Modifications
(Continued)

<u>CTIA</u>

- **Reduce transition to unified cost-based termination rates from 10 years to 5 years**
- **Five year transition from current CETC support levels (I.e., Identical Support Rule) to successor mechanism(s)**
- **Seek comment on an appropriate universal service mechanism for advance wireless services in high-cost areas**

Ex-Parte Modifications

(Continued)

Free Press (Consumer Group)

- The FCC should order a two-year reduction of state access rates to interstate levels, and allow states to determine final rate levels at the end of the transition
- SLC increases should not be allowed without a cost review process, and be phased-in as access rates decline
- Vertically integrated carriers that will be net beneficiaries of declining access rates should not increase their SLCs
- RM funding should be based on actual need (including unregulated revenues), and not to make carriers whole
- RM funding should sunset after five years, absent further FCC action
- FCC should leave the issue of whether VoIP is an "information service" to a further Notice

Areas Where Copps, Adelstein, Tate and Mc Dowell See Consensus

- **Moving intrastate access rates to interstate levels**
- **Not unduly increasing basic rates**
- **Addressing Phantom Traffic and Traffic Pumping issues**
- **Implement an alternative cost recovery mechanism in certain circumstances**
- **Eliminate the Identical Support Rule and move to support based on company's own costs**
- **Broadband should be supported by universal service**
- **Special consideration for Alaska Native Regions and Tribal Lands**

Areas Where Martin Questions Consensus

- **Do we include broadband within the universal service definition, or not?**
- **How do we provide support to competitive ETCs?**
  - Based on their own costs?
  - Reverse Auctions?
  - Phase out CETC support altogether?
- **Should terminating rates be uniform by state – or uniform by carrier?**
- **Should we use an incremental cost standard for terminating rates – or the existing TELRIC standard?**

NECA “Discussion Proposal”

- **Prompt action on “Consensus” items**
  - State access to interstate levels with adequate Restructure Mechanism
  - Modest SLC increases in conjunction with a federal rate benchmark
  - Address “phantom traffic” with Chairman’s proposal
  - Eliminate “identical support rule” and base CETC support on costs
  - Commitment to universal broadband deployment with reasonable terms
- **Don’t do things that don’t make sense**
  - Don’t force rates unreasonably low
  - Don’t replace TELRIC with “additional costs” standard
  - Rates should be unified by carrier, not by state
  - Do not impose new caps on universal service
  - Do not declare VoIP service to be an “information service”

Comments Filed Nov 26

- **Cable (also VON)**
  - VoIP is an “information service”
  - “Additional Cost” standard should replace TELRIC
  - VoIP providers retain Section 251 and 252 rights
  - USF should not be used to keep RLECs whole
- **CLECs**
  - VoIP is a “telecommunications service”
  - TELRIC must remain the ICC pricing standard
  - Preserve current interconnection rights
  - USF should not be used to keep RLECs whole
- **Consumer**
  - VoIP is a “telecommunications service”
  - TELRIC must remain the ICC pricing standard
  - USF and SLCs should not be used to keep RLECs whole
  - Encourage broadband deployment in rural areas

Comments Filed Nov 26
(Continued)

- **RBOCs**
  - AT&T vs. Verizon
- **Wireless**
  - Shorter transition to unified rates (5 years)
  - Single statewide rate based on “additional costs”
  - Reject the Rural Transport Rule
  - Keep USF support to CETCs flowing (focused on broadband)
  - USF should not be used to keep RLECs whole
- **States**
  - No preemption of States rights to regulate intrastate access
  - VoIP is a “telecommunications service”
  - Rates based on TELRIC
  - USF and SLCs should not be used to keep RLECs whole, but…
  - Reasonable steps to preserve and enhance rural networks

Comments Filed Nov 26
(Continued)

Three different RLEC strategies

1. Support Appendix C with modifications
2. Support limited action on “Consensus” issues
3. Support a new Plan

Where Do We Go From Here?

- **Will an Order be issued December 18? (January?)**
- **How will a new FCC impact the ICC/USF debate?**
  - New Chairman and Commissioners
  - “Learning Curve” issues
  - What will be the new Chairman’s priorities??
- **What other external changes will influence the outcome?**
  - Economy
  - Market/Technology changes
  - Political changes
- **Are we better off getting a deal now or later?**
  - Keep whole at what level?

Where Do We Go From here
(Continued)

- **How will the RLECs play the game?**
  - Can we unite behind a common strategy?
  - What will our strategy be?
    - Appendix C with modifications
    - Further delay and hope for better outcome
    - Limited Order on “consensus” items
      - » State to Interstate with RM
      - » Phantom Traffic solution
      - » USF Contribution fix
      - » Others?
    - New Plan
- **What is our Plan B?**
  - Where will the money come from to preserve and improve rural networks?

For More Information:

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