

Universal Service Fund (USF), Intercarrier Compensation (ICC), and Broadband Stimulus Funding

Survival for Rural ILECs

Tri-State TOC

May 13, 2009

Glenn Brown

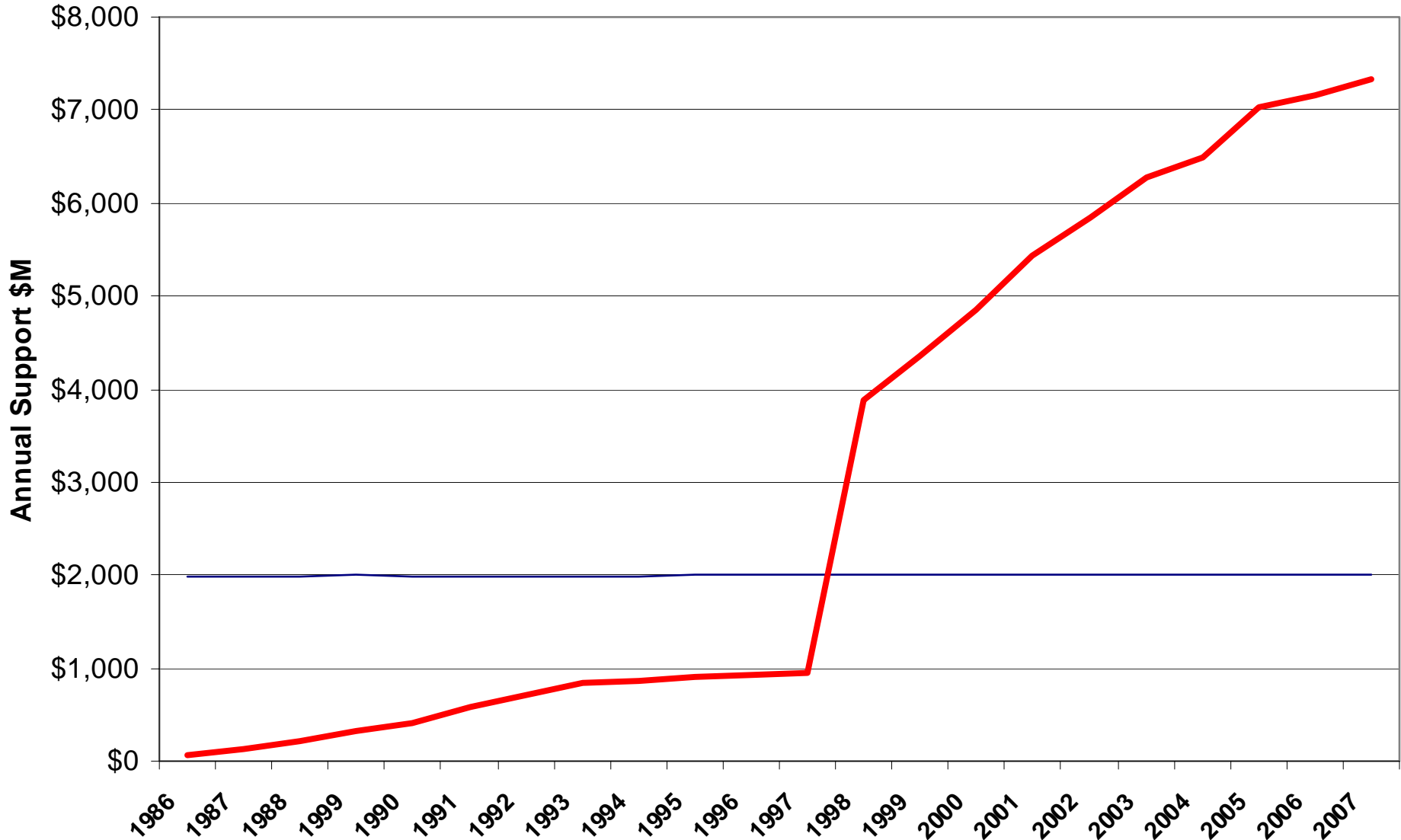
gbrown@mcleanbrown.com

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%

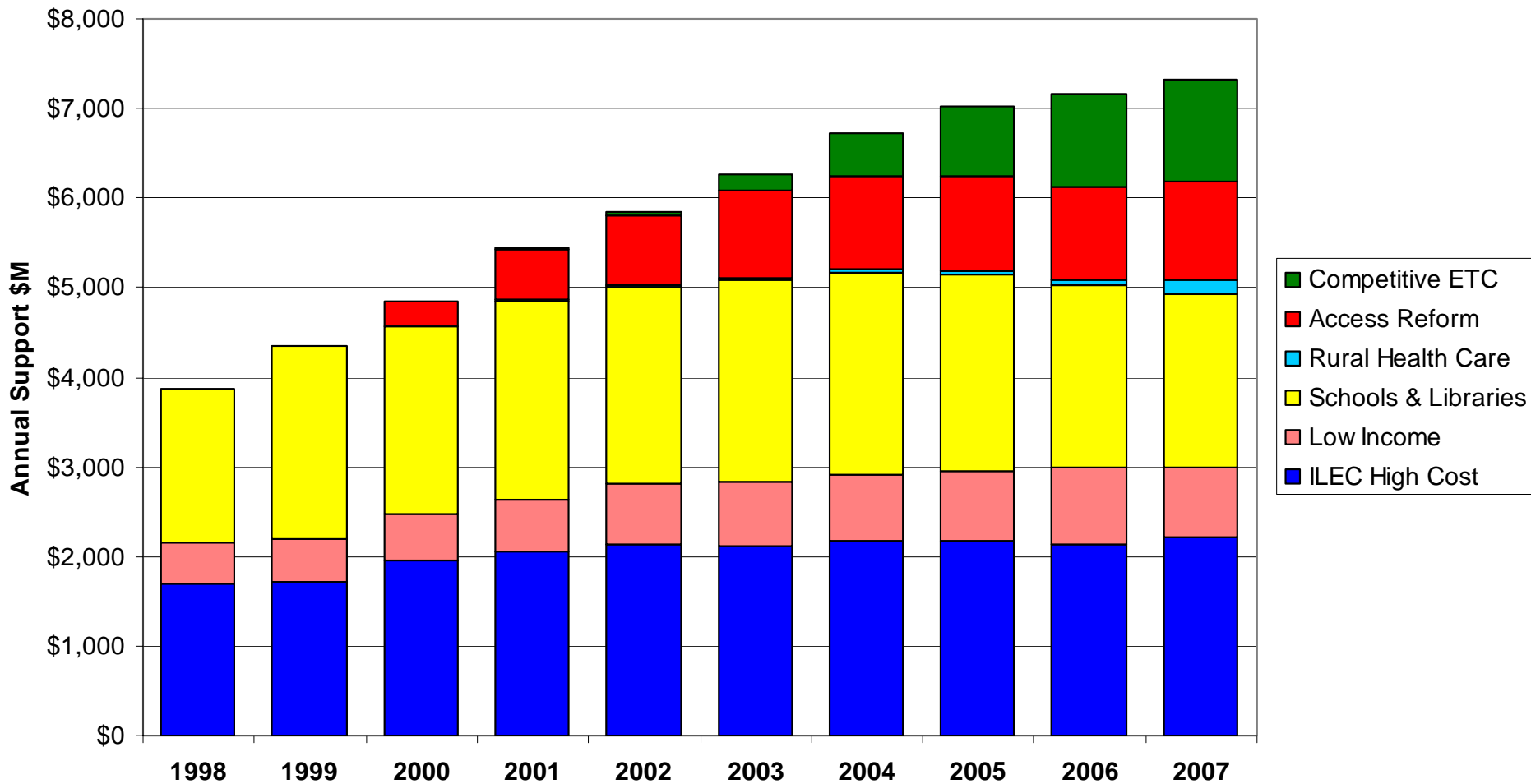
Both Programs Face Serious Challenges

Growth in the USF

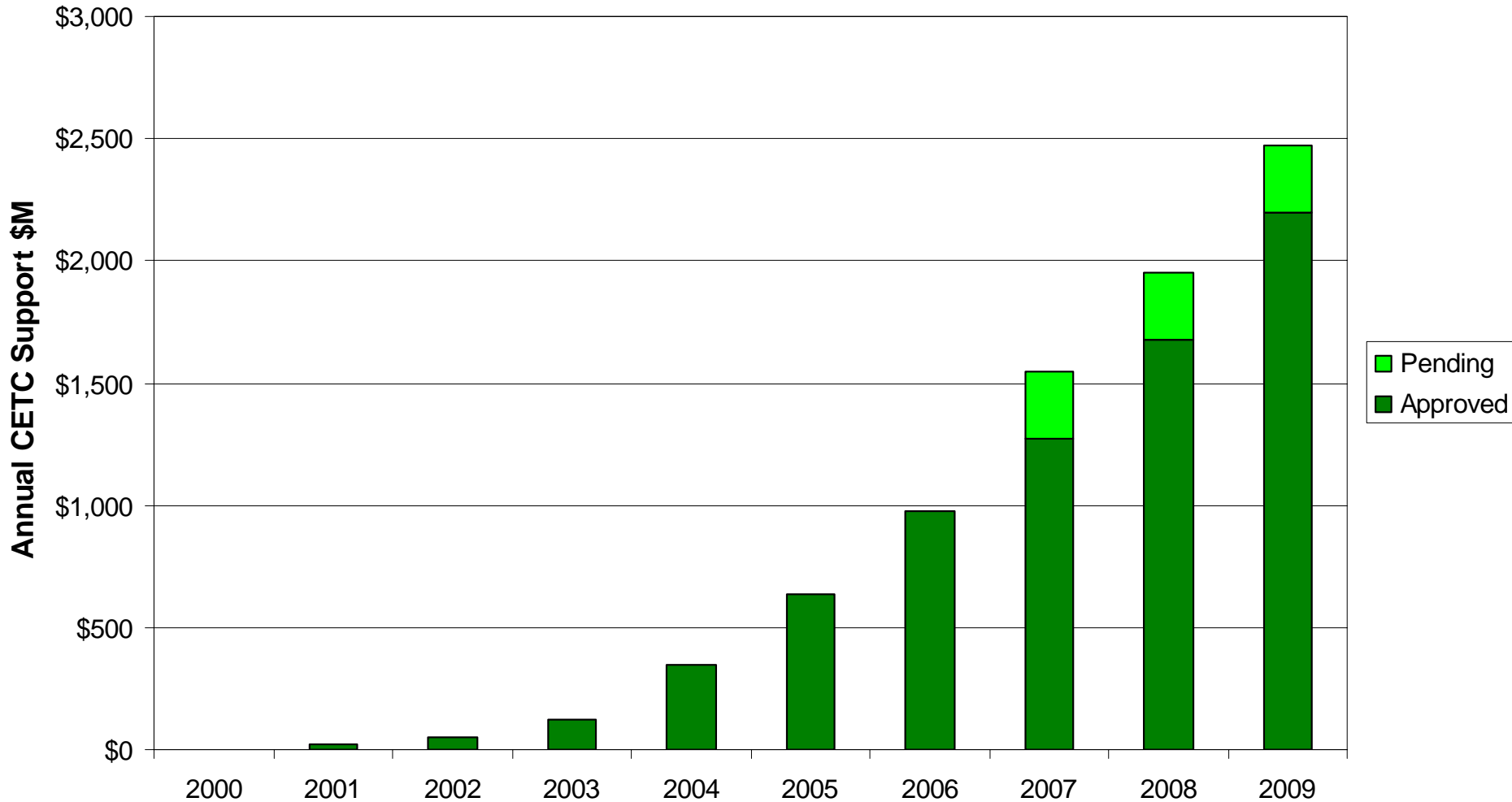


McLean & Brown

Recent Growth Has Been Due to CETCs



Change in CETC Funding is Needed



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
- **May 1, 2008 – FCC caps CETC support**
- **November 5, 2008 – FCC rejects Joint Board recommendations for USF reform**

Challenges to USF

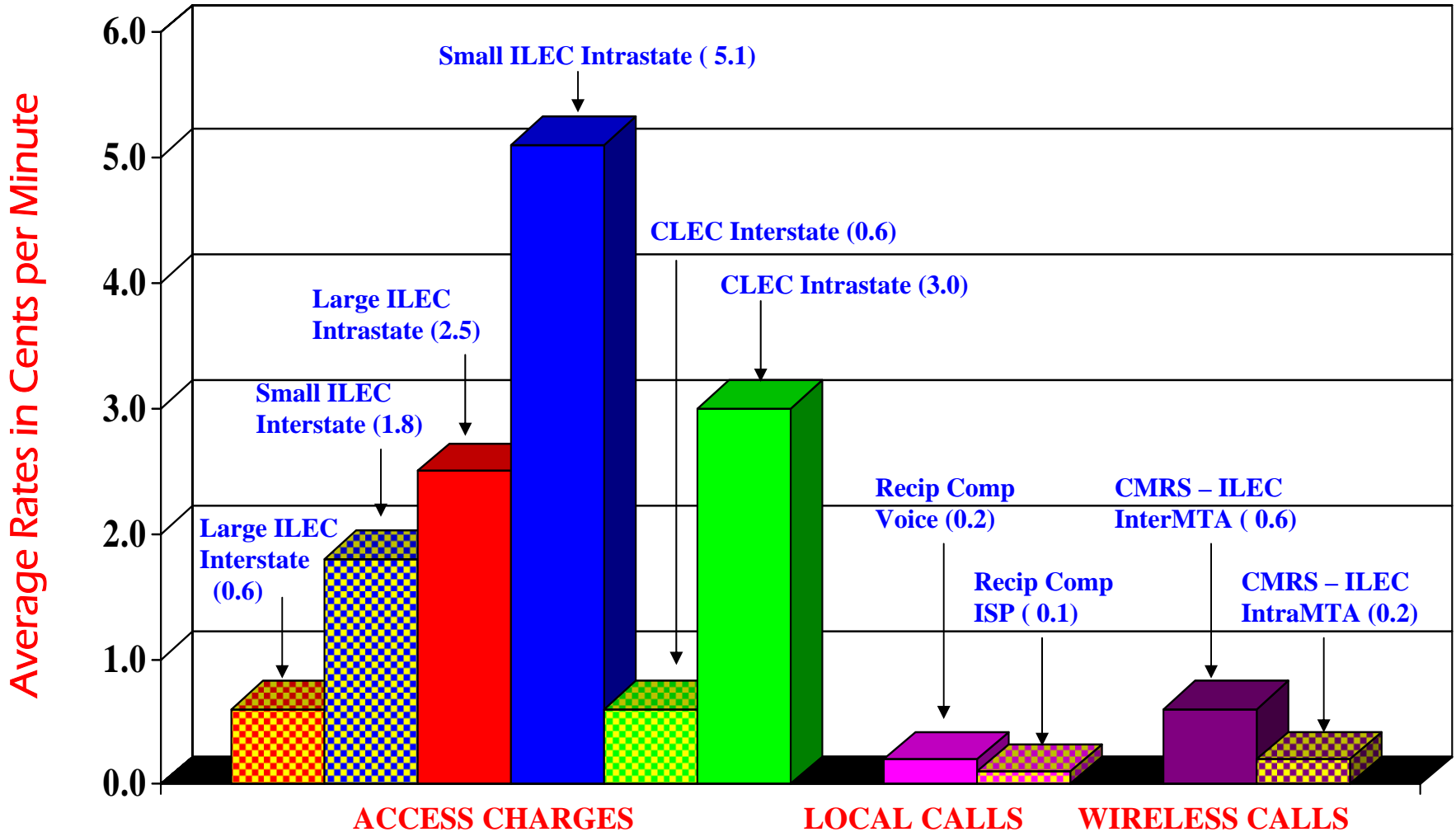
- 1. Political pressure to cap, reduce the size, or eliminate the fund**
- 2. USF Contribution Mechanism**
- 3. Funding to Competitive ETCs**
- 4. Reverse Auctions**
- 5. Broadband**
 - Should it be included in USF?
 - Should 100% broadband availability be required?
 - How will \$7.2B of stimulus funding impact USF?
- 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



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 – 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 fails to act prior to Martin’s departure

Rural Alliance ICC Reform 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

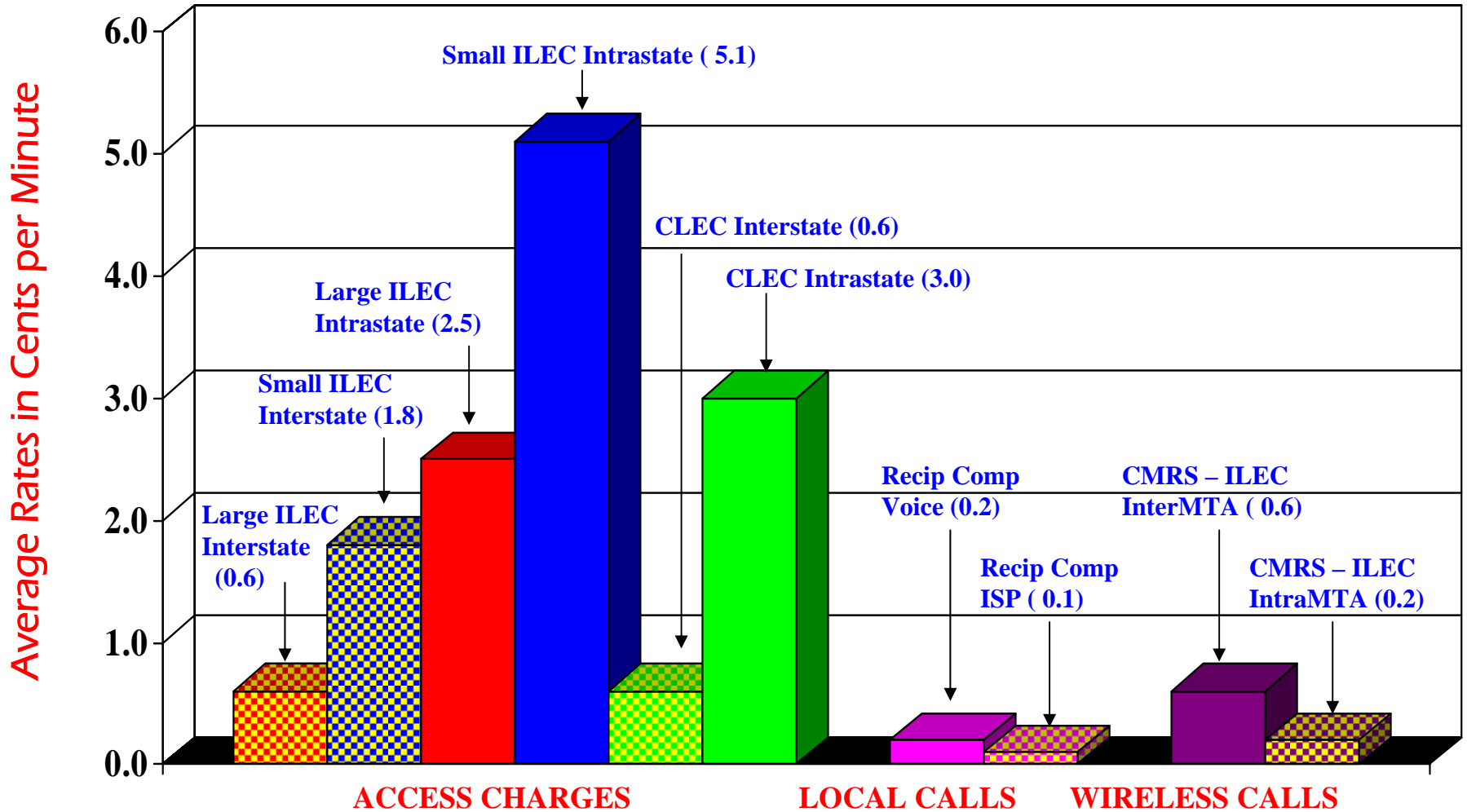
The Missoula Plan met all of these critical goals

-- But it never went anywhere

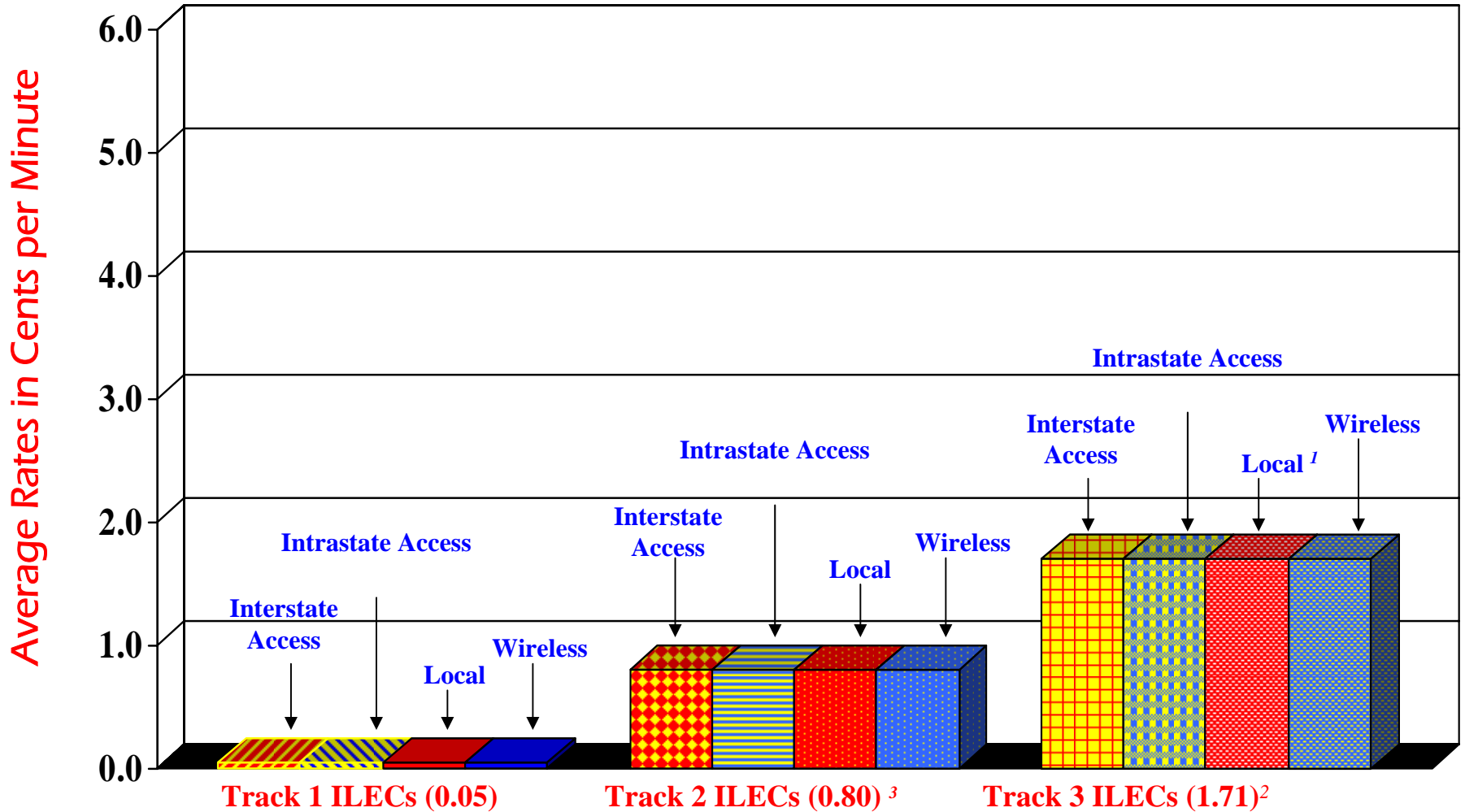
Major Components of Missoula Plan

- **Three “Tracks”**
 - Track 1 – Large Price Cap Carriers
 - Track 2 – Mid-Size Carriers
 - Track 3 – Small RoR Carriers
- **Track 3 carriers unify ICC rates at 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...



With This...



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 \$0.0007 rate in our future?**

End of Year 2008

- **Martin issues “Comprehensive Solution”**
 - Transition to uniform terminating rate (0.0007 → \$0.00001)
 - RoR carriers “made whole” after SLC cap increases
 - Phantom Traffic – unidentified traffic pays highest ICC rate
 - VoIP is “information service” and doesn’t pay access or recip comp
- **Copps, Adelstein, Tate and McDowell see “Consensus”**
 - Intrastate Access to Interstate rate levels
 - Implement alternative cost recovery mechanism in certain circumstances
 - Address Phantom Traffic and Traffic Pumping
 - Eliminate Identical Support Rule
 - Broadband supported by universal service

End of Year 2008

- **Chairman Martin seeks to find a compromise solution**
- **The RLEC Industry splits**
 - One group negotiates improvements to Martin's Plan
 - Another group holds firm to its position and opposes compromise
- **January, 2009 – NOTHING HAPPENS!!**
 - Tate leaves office
 - Martin leaves office
 - ICC and USF reform goes on the back burner
 - Congress instructs FCC to work on DRB transition

New in 2009

- **President Obama nominates:**
 - Michael Copps (D) to Acting FCC Chairman
 - Julius Genachowski (D) to Permanent FCC Chairman
 - Jonathan Adelstein (D) to head RUS
 - Mignon Clyburn (D) to Commissioner
 - Unknown – (R) Commissioner to replace Tate
 - Unknown – (D) Commissioner to replace Adelstein
 - Unknown – will McDowell (R - term exp. 6/1/09) be renominated?
- **NTIA/RUS gear up to distribute \$7.2B broadband stimulus**
- **FCC issues NOI to develop National Broadband Plan**
- **8th Circuit finds states cannot assess USF to VoIP and “Information Services”**
- **Not new – Access minutes continue to decline**
 - “Keep whole” - at what level?

Broadband Stimulus

- **American Recovery and Reinvestment Act of 2009 (ARRA)**
- **\$7.2 billion of total broadband funding**
 - \$4.7 B to NTIA for grants - Broadband Technology Opportunity Program (BTOP)
 - \$2.5 B to RUS for grants and/or loans
- **Major portions of the program remain undefined**
 - Six public hearings to gather input, Comments filed April 13
 - Very “diverse” group of participants
 - “Broadband,” “unserved,” “underserved,” and “nondiscrimination “
 - Qualifications and evaluation criteria for grants/loans
 - Three Notice of Funds Availability (NoFA) rounds:
 - 1) Apr – June 2009, 2) Oct – Dec 2009, 3) Apr – June 2010
 - All funds must be awarded by
 - Preference to States, Indian Tribes, and non-profits
 - Application and funding guidelines May-June timeframe
 - Impact of stimulus funding on USF and RoR carriers unknown

Speakers at NTIA/RUS Meetings

American Assn. of People with Disabilities	CWA	Native Public Media	Pisgah Communications Consulting
American Cable Assn.	DC PSC	Nat'l Assn. of Area Agencies on Aging	Premiere Project Management
American Library Assn.	Dept. of Commerce	Nat'l Assn. of Counties	Public Knowledge
American Telemedicine Assn.	Digital Inclusion Programs	Nat'l Assn. of Development Organizations	Ronson Network Services
Appalachian Regional Commission	ETC Group	Nat'l Assn. of Telecom. Officers and Advisors	Rural Cellular Assn.
Argent Associates	Flagstaff Family Food Center	Nat'l Congress of American Indians	Rural Local Initiatives Support Corp.
Arizona 911 Administrator	Flagstaff Police Dept.	Nat'l Council on Aging	San Carlos Apache Telecom. Utility
Arizona Department of Commerce	Foundation for the Blind	Nat'l Emergency Number Assn.	Santa Clara Univ. School of Law
Arizona Information Technology Agency	Free Press	Nat'l Rural Electric Coop Assn.	Telecommunications Industry Assn.
Arvig Communications	Hopi Telecommunications	Nat'l Rural Health Assn.	Tohono O'odham Utility Authority
Asian American Justice Center	Hughes Communications	Nat'l Tribal Telecom. Assn.	Tri-County Telephone
Assn. of Public Safety Officials	ITTA	Navajo Education Inc.	Univ. of California, San Diego
Bristol Virginia Utilities	KeyOn Communications	NCTA	Univ. of Pennsylvania
Cable One	Leadership Conference on Civil Rights	Nevada Assn. of Counties	US Chamber of Commerce
CC Communications	Living Cities, Inc.	Nevada Commission on Economic Development	US Dept. of Energy
Chickasaw Nation	Lynch Interactive	Nevada Rural Housing Authority	US Pan Asian Chamber of Commerce
City of Flagstaff	M2Z Networks	Nevada System of Higher Education	US Public interest Research Group
City of San Francisco	MA Dept. of Telecom. And Cable	New America Foundation	US Small Business Assn.
Coconino County, AZ	Media and Democracy Coalition	Northern Arizona University	USDA
Coeur d'Alene Tribe	Minority Business Council	NTCA	USTA
Columbia Univ.	Minority Media and Telecom. Council	NY PSC	WildBlue
Communities Connect Network	NARUC	One Economy	Wireless Communications Assn.
Consumer Federation of America	National Governors Assn.	OPASTCO	Wireless Internet Service Providers Assn.
Consumers Union	National Grange	Pew Internet Project	WTA
CTIA - The Wireless Assn.	National Science Foundation	Pioneer Communications	

Major Elements of the Plans

- **Attributes of both programs**
 - “Shovel ready” projects that would not be done absent ARRA funding
 - “Technology neutral with non-discrimination and interconnection obligations
 - Goal of multiple competing providers
 - Much of the grant evaluation work will be outsourced
 - Partnering with other ARRA initiatives – “Smart Grid,” transportation, education, health care, etc.
 - OK to apply for both programs, but no duplicate funding
 - States are seeking role in proposal packaging and ranking
- **NTIA – BTOP (\$4.7B)**
 - Grants to cover 80% of selected project costs
 - \$350M for broadband availability mapping, \$250M for innovative programs for sustainable broadband adoption, \$200M for public, \$10M for audits
- **RUS (\$2.5B)**
 - Combination of grants and loans
 - 75% of project must be “rural”
 - Priority to existing borrowers

Not Your Father's RUS Application

- **Intense competition for limited funding**
- **Successful grant applications must stand out from the crowd**
 - Clear, concise and compelling
 - Demonstrate jobs creation and tie-in with other ARRA goals
 - Partner with favored groups – States, Tribes, non-profits, education, health etc.
 - Demonstrate demand-side innovations
- **Follow principles for effective advocacy**
 - Know the rules, regulations and procedures better than anyone else
 - Understand the needs and priorities of the decision maker
 - Show how your request will serve the public interest and serve decision maker's needs
 - Base advocacy on compelling facts-and-data
 - Present everything in a clear, concise and understandable manner
 - Seek to build partnerships and coalitions to support your position

What This All Means

- **To be successful, the RLEC industry must unite around coordinated policy advocacy**
 - USF and ICC reform
 - National broadband policy development
- **The critical importance of wireline infrastructure must be explained and understood**
- **Policy makers must understand the need for continued ongoing support for network infrastructure in high-cost rural areas**
- **Multi-megabit broadband pipes will become our bread and butter**
- **If we don't tell our story, and tell it well, no one else will**

For More Information:

www.mcleanbrown.com
gbrown@mcleanbrown.com
928-284-3315