FCC's Universal Service and Intercarrier Compensation Reform NPRM

What does it mean for

Rural Montana Consumers?

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The National Broadband Plan

- **The NBP Offered a Bold Vision**
  - Broadband = Great infrastructure challenge of the 21st Century
  - 100 Mbps service to 100M households by 2020
  - Game-changing benefits in – Health Care, Education, Energy, Economic Opportunity, Government Performance, Civic Engagement and Public Safety
- **But as written, the NBP would harm rural America**
  - "Digital Divide" – 100 Mbps urban vs. 4 Mbps rural
  - "Broadband Availability Gap" Model
  - Up to 90% reduction in current USF funding to RLECs
  - Redeployment of support to "unserved" areas
  - Elimination of RoR Regulation
  - Universal Service funding capped at 2010 levels
- **This NPRM is the first step in implementing the NBP**

Glossary
(Basic)

- **RLEC – Rural Local Exchange Carrier**
  - All MITS and MTA members are RLECs
  - RLECs depend heavily on USF and ICC to deliver high-quality, affordable service to rural consumers
- **USF – Universal Service Fund (Explicit Support)**
  - High-Cost – Funding to carriers serving high cost-to-serve areas
  - Low Income, Schools & Libraries, Rural Health Care – Other explicit USF programs
  - The NPRM proposes to cap combined USF and CAF funding at 2010 levels
- **CAF – Connect America Fund**
  - CAF will eventually replace all High-Cost universal service funding for voice and broadband services
  - MF – Mobility Fund – Targeted replacement funding for wireless Competitive ETCs
- **ICC – Intercarrier Compensation (Implicit Support)**
  - Fees that carriers pay each other for origination and termination of traffic, usually on a Minutes of Use (MOU) basis
  - Intrastate Access – Calls originating and terminating within the state
  - Interstate Access – Calls that originate in one state and terminate in another state – regulated by the FCC
  - The NPRM proposes that long-term all access charges go to zero
- **NPRM – Notice of Proposed Rulemaking**
  - In this NPRM the FCC seeks to reform current USF and ICC regimes for a broadband world
  - The NPRM has several windows for the public to comment on proposed reforms
    - Short Term ICC reforms – Comments 4/1, Reply Comments 4/18
    - USF and Long Term ICC reforms – Comments 4/18, Replies 5/23
    - State Joint Board Members – Comments 5/2

Rural Local Exchange Carriers

- **Rural Local Exchange Carriers (RLECs) role:**
  - Serve rural areas that Bell found unprofitable
  - Serve as Carriers of Last Resort (COLR) for high-cost areas
  - Broadband service to millions of rural consumers
  - Back-haul and middle-mile functions for wireless and others
- **Telecommunications Act of 1996**
  - Rural consumers should have comparable services and rates – 254(b)(3)
  - There should be "specific, predictable and sufficient" mechanisms – 254(b)(5)
- **In addition to their end-user customers, RLECs rely heavily on two other sources to recover their network costs:**
  - Universal Service Fund (USF)
  - Intercarrier Compensation (ICC)
  - On average, nationwide, RLECs receive 70% of revenue from USF & ICC
- **Interstate Rate-of-Return (RoR) Regulation**
  - RLECs entitled to cover their costs and earn a reasonable return
  - USF and ICC recover costs not covered by end-users

High-Cost USF

- **Statewide Statistics – RLECs (MITS & MTA Members)**
  - Total Recipients 15
  - Total Support $56.8M per year
  - Average Support $49.78 per line per month
  - Median Support $47.78 per line per month
  - High $147.51 per line per month
  - Low $13.41 per line per month
- **Other ILECs**
  - Qwest $12.0M $4.98 per line per month
  - Century $2.8M $4.67 per line per month
  - Frontier $0.8M $9.13 per line per month

- **Competitive ETCs $20.4M**
- **Total High-Cost $92.8M**

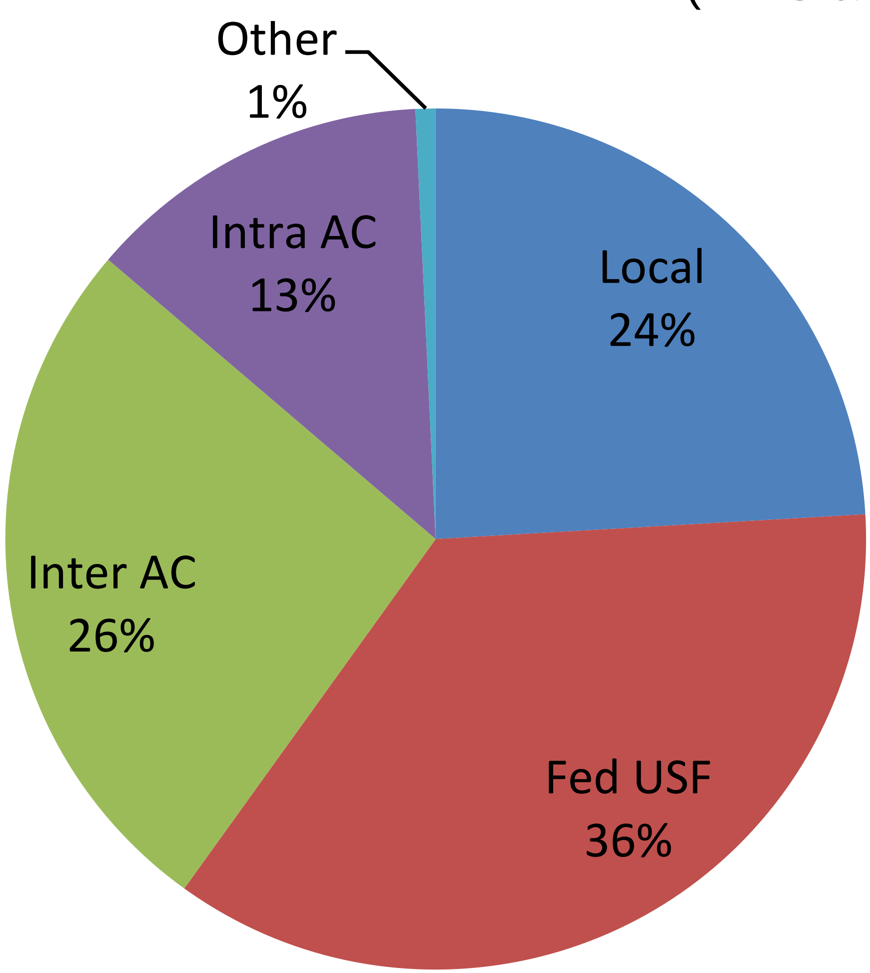
Source: 2020 Universal Service Monitoring Report, Lines USAC HC05 4Q10, Qwest Lines HC12 4Q10

RLEC Intercarrier Compensation

- **Interstate Access**
  - Regulated by the FCC
  - Average RLEC rate 3.93 cents per minute
  - Approximately $37 per line per month
- **Intrastate Access**
  - Regulated by the MT PSC (Commercial Companies only)
  - Average RLEC rate 8.22 cents per minute
  - Approximately $19 per line per month
- **NECA has calculated that to bring MT intrastate rates to interstate levels would add about $6 to the average consumer’s phone bill**

RLEC Sources of Revenue

(MITS & MTA)



Source	Monthly per Line	Percentage
Local	$34.28	24.1%
Fed USF	$51.02	35.8%
Inter AC	$37.45	26.3%
Intra AC	$18.52	13.0%
Other	$1.07	0.8%
	$142.34	100.0%

Red = In Play in this NPRM

Includes over 95% of MITS and MTA access lines

What is in the NPRM?

- **Goals and Priorities for USF and ICC Reform**
  1. Modernize USF and ICC for Broadband
  2. Fiscal Responsibility
  3. Accountability
  4. Market-Driven Policies
  5. Avoid sudden changes or Flash-Cuts
- **Major Transitions for USF and ICC**
  - Short Term
    - ICC – Fixes for access stimulation, phantom traffic, VoIP
    - USF – “Reform” to current mechanisms and introduce Phase I Connect America Fund (CAF)
  - Long-Term
    - ICC – Per-minute charges eliminated, explicit CAF support
    - USF – All funding from CAF and MF

Intercarrier Compensation

- **Rates paid by one carrier to another carrier to originate or terminate its traffic**
  - Generally expressed as rate per Minute of Use (MOU)
- **Different rates for different services**
  - Interstate access – regulated by FCC
  - Intrastate access – regulated by MT PSC
  - Reciprocal compensation – negotiated/arbitrated
  - Local calling – “free”
- **Have historically provided “implicit support” for universal service**
- **MOU will go away as broadband connections replace the Public Switched Telephone Network (PSTN)**

Major ICC Problems

- **Phantom Traffic**
  - Removing or altering call signaling information to have traffic billed at a lower rate, or not billed at all
  - In any other industry this would be called “theft”
- **Traffic Pumping**
  - A business with large amounts of inbound traffic (i.e., conference call, chat line) locates behind a carrier with high access rates
  - The business and carrier share access revenues
  - To the consumer the cost is “free,” but someone else pays
- **VoIP service originating or terminating on PSTN**
  - FCC has dragged its feet on “classifying” VoIP traffic
  - Carriers are refusing to pay
  - Does IP “pixy dust” make a call free?

Blueprint for ICC Reform

Today	Near-term	Future-State
Different rates for: • Intrastate access (states jurisdiction) • Interstate access (FCC jurisdiction) • Reciprocal compensation ("local" traffic, FCC sets methodology, states implement)	• Adopt rules to address phantom traffic and access stimulation, and determine the treatment of VoIP for purposes of ICC • Adopt framework for long-term ICC reform, including glide path and recovery mechanisms • Begin reducing rates, together with implementation of recovery mechanisms	• Transition away from per-minute rates is complete, replaced with explicit support where necessary from Connect America Fund under long-term vision

Short-Term ICC Reforms

- **Phantom traffic**
  - Amend signaling rules to require adequate billing data
- **Access stimulation**
  - Carriers with revenue-sharing arrangements must re-file tariffs
    - RoR – Adjust rate to reflect new demand
    - CLEC – Benchmark to large ILEC
- **Determine obligations for interconnected VoIP traffic**
  - Three options:
    1. Bill & Keep
    2. Standard ICC rates
    3. VOIP-specific rate (e.g., $0.0007)

Long-Term ICC Reforms

- **FCC seeks comments on:**
  - Federal/State role options
    - Federal does interstate, states do intrastate, or
    - Federal uses 251/252 rules to unify all ICC under reciprocal compensation
  - Sequencing
    - Should state and interstate move together, or
    - Should state move to interstate, and then interstate to ultimate levels
  - Glide path to take all ICC to zero, with all explicit support coming from CAF
- **Should ICC really go to zero?**
  - Who benefits, and who pays?

Universal Service

- **Four Programs**

	2010 $M	
Fund	**USA**	**Montana**
High Cost	$4,752	$92
Low Income	$1,400	$6
Schools & Libraries	$2,250	$5
Rural Health Care	$43	$0
Total	**$8,445**	**$103**

- **High-Cost Fund Recipients**

	2010 $M	
High-Cost	**USA**	**Montana**
RLEC	$2,016	$60
Price Cap	$1,040	$12
CETC	$1,696	$20
Totals	**$4,752**	**$92**

- **Long-term all Universal Service Funding moves to the new Connect America Fund (CAF)**

Competitive ETCs

- **Competitive Eligible Telecom. Carriers (CETCs)**
  - To receive USF support, a carrier must be an “ETC” – 214(e)
  - States given the role of designating ETCs – 214(e)(2)
  - CETCs provided same per-line support as wireline incumbent
  - The “Identical Support Rule” has created multiple problems
    - No relationship between actual cost and support
    - “Explosive” growth in the fund, with unclear results
    - FCC “capped” statewide CETC funding in 2008
    - Wireless mergers required voluntary phase-out of CETC funds
    - NPRM phases-out CETC funding and creates new “Mobility Fund”
- **Montana CETCs**
  - MT PSC lagged in CETC designations; Lead the Nation in adopting comprehensive ETC rules
  - Explosive growth in USF not tied to MT

Transition to CAF

Today | **Transition Period** | **Future-State**

Existing High-Cost Fund

- **Connect America Fund – Phase I**
- **Mobility Fund**
- **ICC Recovery**

Reformed High-Cost Fund

Connect America Fund

- Initial selection of long-term CAF option
- Monitoring and evaluation

Short-Term CAF Implementation

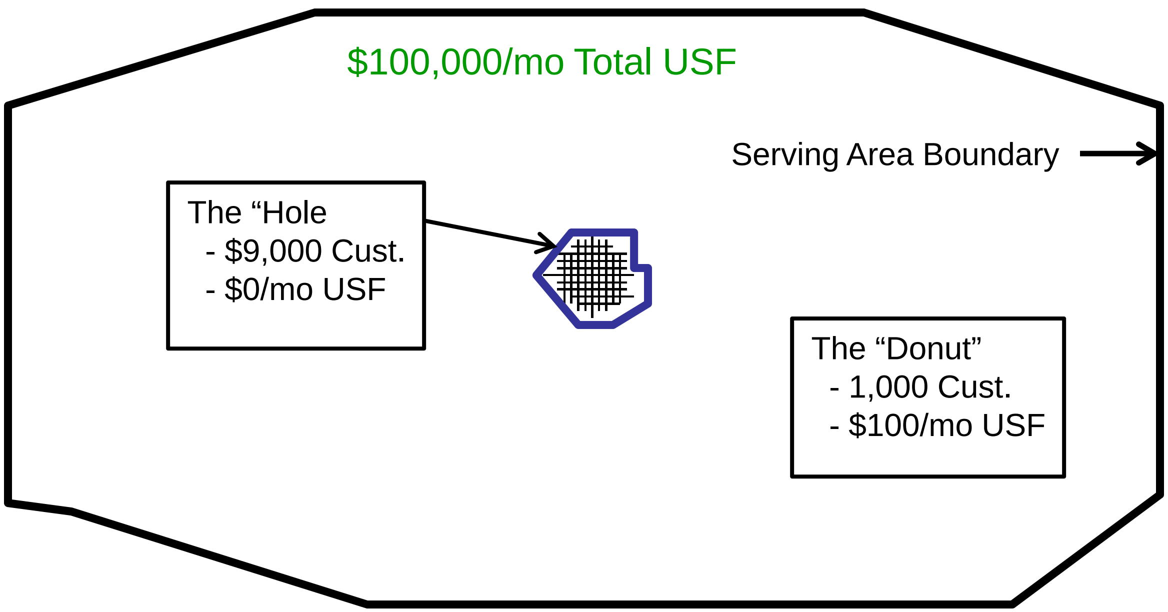
- **“Repurpose” certain high-cost funding**
  - Phase out IAS for Price Cap carriers
  - Phase out CETC support
  - “Reform” current high-cost mechanisms
  - Start RoR carriers on path to market-driven, incentive-based regulation
- **“Unserved” areas identified from National Broadband Map**
  - $500M - $1B of funding in 2012 (Derived from CETC and IAS elimination and other “savings”)
  - Awarded to single provider through competitive auction
- **Accountability and tracking measures (USF and CAF)**
  - Performance goals and measurements
  - Report on broadband pricing

“Reform” High-Cost Mechanisms

- **Adjustments to “capped” HCL ($26.7M) funding**
  - Reduce funding percentages:
    - 115% to 150% of NACPL reduced from 65% to 55%
    - Over 150% of NACPL reduced from 75% to 65%
  - Redistributes capped support among RLECs
- **Eliminate Safety-Net Additive ($0.2M)**
- **Eliminate LSS ($6.0M) or combine with HCL**
- **Eliminate corporate operations expense (?)**
- **Limits on cap-ex and op-ex (?)**
- **Limits on per-line support**
  - $250/line/mo. $3,000/year

"Reform" High-Cost Mechanisms

- **Remove barriers to efficient consolidation**
  - Streamline study area waiver process
  - Eliminate "Parent Trap" rule
- **Require RLECs to disaggregate USF in 2012**
  - Target support to the "donut'



“We’re Here from Washington, and Here to Help”

- “Current USF programs may have had the unintended effect of providing some carriers more support than is necessary to ensure reasonably comparable voice services at comparable rates.”
- “Although we recognize the benefits of local firms serving local markets, it might not be in the public interest to subsidize so many small companies, when those companies could realize efficiencies in scale that would have little impact of the customer experience.”
- “To the extent these proposals would impact cash flow and ability to repay loans, how should we take that into account while balancing our commitment to fiscal responsibility?”

Long-Term USF Reforms

- **Transition all high-cost programs to the CAF**
- **FCC seeks comment on three options for "sufficient, but not excessive" support:**
  1. Award all ongoing support through a competitive, technology-neutral bidding mechanism
  2. Offer the ILEC a right-of-first-refusal for CAF support determined by a proxy model. If ILEC refuses, then auction
  3. Limit ROFR/auction to Price Cap companies. Offer ongoing support "based on reasonable actual investment" to RoR carriers, with capped ICLS support and "an appropriate forward-looking" rate-of-return

Major Concerns

- **Phantom Traffic and Access Stimulation should be addressed immediately**
- **VoIP traffic on PSTN should pay regular ICC rates**
- **RLECs must be provided a reasonable opportunity to recover investment made under old rules, including ARRA-funded projects**
- **Indiscriminate redeployment or reduction of USF could result in rural network failure with severe impact on rural consumers**
- **An “evolved” RoR-based CAF mechanism can provide the ability and incentive for RLECs to invest in high-cost broadband infrastructure to serve rural consumers**

Major Concerns

- **The critical importance to Montana consumers of cost recovery, predictability and sustainability for all RURAL high-cost carriers**
- **Arbitrary preemption of intrastate access regulation would not serve the public interest**
- **There must be a sustainable restructure mechanism to replace implicit support lost through ICC reform**
- **The FCC must act immediately to reform the USF collection mechanism to be sustainable in a broadband environment, and to provide sufficient support to ensure that all Americans have access to affordable and comparable broadband services**