

New Rules Proposed for Reform of Universal Service and Intercarrier Compensation

02.08.11

By Michael C. Sloan

In its open meeting earlier today (Feb. 8, 2011), the FCC adopted a Notice of Proposed Rulemaking (NPRM) to reform the Universal Service Fund (USF) and the Intercarrier Compensation (ICC) system, both of which Chairman Julius Genachowski said are “plagued with waste and inefficiency.” Although the text has not yet been issued, we outline our expectations for the proposal in this advisory. After the NPRM has been issued, we will update our advisory as necessary.

Anticipated USF proposals

On the USF side, the NPRM will call for consolidating several of the separate funds into one fund to support deployment of broadband, moving away from supporting just “plain old telephone service.” The new fund (dubbed the “ConnectAmerica Fund” (CAF) in the National Broadband Plan issued last March) will be targeted first toward geographic areas where there is no broadband service currently, and where there is little prospect for private sector deployment of broadband. (How these geographic areas are defined will be an important issue to watch.) The CAF will be supplemented by a “Mobility Fund” for wireless broadband services, which the Commission called for in an NPRM issued last fall.

The Chairman said at the meeting, and the press release issued afterward reiterates, that “market-driven and incentive-based policies” will be deployed to “maximize the impact of scarce program resources and the benefits to all consumers.” We take this to mean that the FCC will propose to make awards based on a competitive grant process (such as that used to distribute broadband stimulus funds) and/or “reverse auctions,” in which existing and potential service providers bid for the lowest subsidy they would accept to serve an area (which in many markets could be zero). In all cases, we expect that the proposal would limit funding to one wireline and one wireless service provider in each area.

This effectively adopts the long-standing cable industry proposal that no subsidy should be provided where an unsubsidized competitor provides service, and would greatly reduce the number of areas where subsidies are provided. Competitive carriers that currently receive high-cost USF support as the second or third “Eligible Telecommunications Carrier” (ETC) in a market could be adversely affected by this proposal.

We expect the plan to call for a fairly lengthy transition period—perhaps as long as a decade until all legacy high-cost programs would be eliminated under the proposal.

As Commissioner Robert McDowell noted, conspicuously absent is any proposal for reforming the USF contribution system, which is not only notoriously confusing but which has risen precipitously from less than 5 percent to upwards of 15 percent of consumer telephone bills as the USF fund has ballooned during a period of shrinking interstate telecommunications revenue.

Anticipated intercarrier compensation proposals

The problems with the current intercarrier compensation (ICC) regime are notorious. It does not appear that the NPRM will attempt to solve them all, but will instead focus on clarifying the treatment of interconnected VoIP traffic, phantom traffic, and traffic pumping. We address each below:

Interconnected VoIP traffic

The interconnected VoIP traffic issue arises from traffic exchanged by local exchange carriers (LECs) that is either destined to or originated by interconnected VoIP service providers. Some interexchange carriers (IXCs) take the position that this traffic is “information services” traffic and therefore exempt from access charges. LECs that want to *collect* access charges, not surprisingly, take the opposite view.

It appears that the FCC’s proposal may call for treating such traffic as telecommunications traffic, and therefore subject to either access charges or reciprocal compensation, as appropriate. This does not mean we expect the FCC to rule that VoIP itself is a telecommunications service. But we do think that it will clarify that when LECs exchange

such traffic to facilitate calls to and from the public switched telephone network (PSTN), such traffic is telecommunications and subject to treatment as such.

Phantom traffic

“Phantom traffic” is another access charge avoidance scheme in which carriers attempt to exchange long-distance traffic over local trunks and disguise what they are doing by removing necessary call detail information. The Chairman indicated at the meeting that the NPRM will propose rules that require accurate call information in all signaling streams. The FCC might even propose a rule deeming the failure to provide such information a violation of the Communications Act and also propose various enforcement mechanisms to help ensure compliance.

Traffic pumping (a/k/a “traffic stimulation”)

“Traffic pumping”—also known as “traffic stimulation”—is a practice by which LECs with high terminating access rates—often 10 times higher than the norm among incumbent LECs—serve customers that generate large volumes of inbound traffic, such as conference bridges and chat lines. The result is large access bills for IXCs that terminate calls to traffic pumping LECs. The LEC often will charge its customers little or no fee or may even share revenues. Traffic pumping LECs typically operate in rural territories, such as Iowa and South Dakota, and are either small incumbent LECs or rural competitive LECs that are often affiliated with rural incumbent local exchange carriers (ILECs).

High terminating access charges are not a new issue. For example, in 2001, the FCC effectively capped competitive local exchange carrier (CLEC) access at the same level as the local ILEC, and, in *Total Telecom v. AT&T*, adjudicated a dispute between an IXC and a traffic pumping ILEC in favor of the IXC. In the spring of 2007 the issue came to a head when a number of carriers on both sides of the issue petitioned the FCC for relief and/or a clarification of their rights. In a Declaratory Ruling issued in June 2007, the FCC made one thing perfectly clear: Aggrieved IXCs may not block calls. But it did not provide IXCs any relief, and calls for reform continue to this day.

In October 2007, the FCC issued proposed new or revised rules to address traffic pumping concerns. In addition to seeking more factual information about the practice, the FCC proposed: (1) an adjustment to costing methodology that would reflect a cost decrease as demand increases; (2) a finding that a rate-of-return carrier that shares revenues with an end user customer is engaged in an unreasonable practice; and (3) tariff filing requirements and language that would modify switched access rates as demand increases.

We expect that the NPRM will largely readopt these proposals for dealing with the traffic pumping “problem.”

Conclusion

The USF and ICC reforms the Commission is calling for will affect nearly every segment of the communications industry. DWT is working with clients to help them assess the impact of these changes on their business. Please do not hesitate to contact your DWT contact or any of the attorneys listed above for additional information.

This advisory is a publication of Davis Wright Tremaine LLP. Our purpose in publishing this advisory is to inform our clients and friends of recent legal developments. It is not intended, nor should it be used, as a substitute for specific legal advice as legal counsel may only be given in response to inquiries regarding particular situations.