Davis Wright Tremaine LLP

FCC Proposed Universal Service Reforms

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In its Feb. 9 Notice of Proposed Rulemaking (NPRM), the FCC announced a variety of proposals to reform the High-Cost disbursement program, which is funded through the federal universal service fund (USF) and is the largest of the four disbursement programs drawing from the USF. These reforms would take place in two stages, with the ultimate goal of transitioning all remaining High-Cost funding, e.g., high-cost loop support, interstate common line support, and high-cost model support, to the Connect America Fund (CAF).

Connect America Fund as Sole Long-Term Source of High-Cost Universal Service Funding

In the NPRM, the FCC seeks comment on a number of alternative ways to reach its ultimate goal of transitioning all High-Cost funding from the USF to the new CAF fund. To this end, FCC suggests two main alternatives. First, it proposes to create a technologically neutral competitive bidding mechanism to award CAF support for voice and broadband services in specified geographic regions. Second, it proposes that the existing carrier of last resort (COLR) in each area (typically the existing landline phone company) would provide voice and broadband services at a rate level calculated through a cost model. If the COLR refuses to provide its services at this rate, competitive bidding to receive CAF support would be implemented in the COLR's service area. The FCC also seeks comment on whether the transition of support to the CAF under either of these approaches should be limited to only those areas served by price-cap companies, and whether it should continue to base support for the smaller rate-of-return incumbent local exchange carriers (ILECs) on reasonable actual investment, in conjunction with possible changes to the current rate-of-return system, including shifting interstate common line support (ICLS) to an incentive regulation framework, scrutinizing more closely whether investment is "used and useful" and re-examining the current and long-standing 11.25% interstate rate of return.

The NPRM repeats the FCC's preference, previously discussed in the National Broadband Plan (NBP), for limiting support to a single carrier per geographic area. However, the FCC also seeks comment on proposals to support both fixed and mobile networks under the CAF. In the event the FCC were to support mobility within the CAF, the FCC seeks comments on changes to the manner in which wireless carrier support is calculated, including replacing the current "identical support rule" with a wireless-specific support calculation mechanism. The FCC proposes two options for comment: (1) development of a simplified cost model based primarily on housing unit density (and perhaps topography and distance from population centers); or (2) a reverse auction for competitive eligible telecommunications carriers (ETCs) in which providers bid for the lowest subsidy that they would be willing to accept to serve an area. To the extent the FCC decides to support mobility with the CAF, it seeks comment on its proposal to support only one wireless competitive ETC per geographic area and whether the wireless ETC should be required to share infrastructure with other non-supported wireless carriers.

The FCC also seeks comment on whether any support is appropriate where voice and broadband services are being provided today without universal service support. In addition, it seeks comment on a host of related issues, including how to determine whether a geographic area is currently served by an unsubsidized carrier, how to properly measure the given geographic area, whether the existence of an unsubsidized carrier today is a reliable indicator of whether future funding will be necessary, and whether either the reverse auction or cost-model mechanism might result in allocating awards to areas that are already served by unsubsidized carriers.

The FCC also seeks comment on how to grapple with areas that no entity wishes to serve. In that situation, Section 254(c) of the Act requires the FCC or a state commission to determine which carrier is best suited to provide service and to order the carrier to provide service. Thus, the FCC seeks comment on whether it or a state commission can or should order carriers to provide broadband service in these unserved areas, and how to determine which carrier is "best able to provide" supported broadband services.

Finally, the FCC seeks comment on whether there should be exceptions to its proposal to only support one carrier per area. For example, should more than one carrier receive support in Tribal lands and native regions in Alaska?

The FCC repeats its concern about maintaining the size of the CAF and proposes to cap the overall budget for both the CAF and any existing High-Cost programs, combined, in any given year to the total size of the High-Cost program in 2010. The FCC seeks comment on alternatives, such as using a different base year, adjusting for inflation, or using a smaller amount than the 2010 total. The FCC also seeks comment on whether it should set the maximum size of the CAF by taking into account the cumulative effect of the other USF support disbursement programs, namely, Low

Income (Lifeline and Link Up), Schools and Libraries (E-rate), and Rural Health Care.

The NPRM goes into great detail in seeking comment on how to structure its alternative competitive bidding and cost-model proposals. With respect to the bidding process, the FCC seeks comment on such issues as: (1) whether bids should be "complete package" or separate out "voice only"; (2) the prospect of using the cost of satellite service as a maximum bid cap for those households that are the most expensive to serve; (3) allowing bidders to provide service using different technologies, including partnering with wireless and satellite carriers; (4) whether to allot bidding credits for exceeding the minimum requirements or offering to serve Tribal lands or insular areas; (5) the size of the geographic areas to auction (e.g., census block aggregations or wire centers); and (6) whether and how to allow satellite providers to bid.

With respect to the development of cost models, the FCC seeks comment on issues such as: (1) whether to base the estimates on a wireline network or the lowest cost technology(ies); (2) whether to use a "green-field" or "brown-field" approach to a wireline-based model; (3) what factors to use in developing the national average benchmark; and (4) whether to consider revenues as well as costs in determining support levels. The FCC also seeks comments on whether to use a more high-level regression analysis-based cost model that may be less accurate, but easier to implement, or a more traditional model that uses numerous data inputs but is more time consuming to develop.

The cost model would be used if the FCC decides to adopt what it called the "right of first refusal" proposal, under which the FCC would calculate the COLR's level of support, and the COLR could either accept that support—and concomitant obligations to provide voice and broadband service—or reject the offer and submit "its" territory to a competitive bid, in which the COLR could choose to participate. If the COLR accepts the offer, it could use any technology (including wireless) to build out to unserved areas and would not be required to extend its existing wireline network. In the most expensive areas, the COLR would also be permitted to use satellite technology. The FCC seeks comments on alternative approaches to the right of first refusal, including having the COLR make an offer of the level of support it believes it needs and letting the FCC either accept or reject that offer. The FCC also seeks comment on whether there may be a need for the COLR to receive a transition off of traditional USF support during the construction period where the COLR has rejected the offer and then loses the bid to a competitive ETC. Finally, the FCC seeks comment on whether it should phase in the right of first refusal approach by extending it to price-cap companies first, or even just to Regional Bell Operating Companies, in order to determine its success prior to rolling out the program to smaller carriers.

Interim Changes to the High-Cost Universal Service Fund

An immediate elimination of the High-Cost program and intercarrier compensation (ICC) regime would be extremely disruptive to the industry and consumers. As a result, the FCC has proposed a transitional phase-in of the new CAF. The proposed transition, which would begin in 2012, would implement a series of changes, many of which have been previously proposed. It would center on the following: (1) launching the first phase of the CAF; (2) creating the Mobility Fund; (3) eliminating the identical support rule; and (4) tweaking or eliminating various High-Cost funding mechanisms, including introducing a per line overall cap on High-Cost funding.

The first phase of the CAF would entail the creation of a "fast track" program to provide a round or two of subsidies to expand broadband to unserved areas. This funding would supplement, rather than replace, any existing High-Cost funding mechanisms. The FCC proposes to award funding to a single provider in areas lacking basic broadband through a reverse auction in 2012, with a potential second round in 2014. Further, it proposes to define areas lacking basic broadband access as those areas lacking services with minimum 768 kbps download speeds. Once funding is awarded, however, it has proposed to require the provider to offer minimum speeds of at least 4 Mbps (actual) downstream and 1 Mbps (actual) upstream, and perhaps would include a requirement to improve the services over time. It has also proposed to allow providers to employ terrestrial wireline or wireless technologies as well as partner with satellite providers. It seeks comment on requiring deployment to be completed within three years and requiring the provider to continue to provide service for an additional five years. It also seeks comment on whether this first phase of CAF should be funded with the savings realized through its other interim reforms to existing High-Cost funding, which it estimates to be close to $1 billion, or whether it should set aside a certain dollar amount, seeking comment on what the dollar amount should be. The FCC has also sought comment on whether it should forbear from (waive) the statutory requirement that providers receiving universal service funding first receive ETC designation, or whether it should simply condition the award of funding on the provider's ultimate designation.

This first phase of the new CAF is somewhat similar to the proposed Mobility Fund, which the FCC is considering in a separate NPRM, in that the CAF would provide a one-time injection of $100 million to $300 million in funding to support the build-out of 3G mobile wireless infrastructure in unserved areas. The funding for the Mobility Fund would come from a portion the High-Cost support reclaimed from Verizon Wireless and Sprint Nextel that those companies

agreed to relinquish in the context of their merger. See our previous advisory for further discussion of this proposal in more detail here.

The FCC has also proposed to eliminate the "identical support" rule under which competitive ETCs receive the same level of High-Cost funding per line as the incumbent ETC in a given service area. Moreover, it proposes to transition competitive ETC funding to the second, final phase of CAF. Specifically, competitive ETC funding, which is currently subject to an interim cap, would be reduced over five years in equal 20% installments, and redirected to the CAF. The funds would then be distributed under the new, market-based mechanisms described above. It also seeks comment on whether it should permit carriers to seek waivers or exemptions during the transition phase.

With respect to the existing High-Cost mechanisms, there are three types of support specifically targeted for reform in the NPRM: high-cost loop support (HCLS), local switching support (LSS) and interstate access support (IAS). HCLS subsidizes the loop costs of rural ILECs and competitive ETCs operating in the same areas. The FCC has proposed to reduce HCLS funding for most carriers by 10%, and eliminate it altogether for carriers with more than 200,000 working loops, after which time the carriers would need to seek funding through the new CAF. It has also proposed to eliminate a mechanism by which these carriers can sometimes qualify for additional funding for incremental investment (known as the "safety net additive"). The second type of funding, LSS, provides support for a switching costs provided to rural ILECs serving less than 50,000 and competitive ETCs serving those territories. The FCC has proposed to eliminate this type of funding, or possibly combine it with HCLS. The third type of support, IAS, provides funding to price-cap ILECs and competitive ETCs operating in the same area to support for local loop costs. IAS was initially conceived as a temporary, five-year funding mechanism to implement related reforms to interstate access ICC rates and universal service. It has proposed to transition IAS funding to the new CAF over a period of five years.

The FCC has also proposed to cap the overall amount of funding that ILECs could receive, on a per line basis, during the interim period of transition to the new CAF. Competitive ETC funding has been subject to an interim cap for over two years, which limits funding to those ETCs at March 2008 levels. The new proposed cap would apply to all carriers, although ILECs could possibly be given the opportunity to seek a waiver upon demonstration that a higher limit would be in the public interest.

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